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THESIS

DOMINICAN REPUBLIC – CENTRAL AMERICAN FREE TRADE AGREEMENT (DR-CAFTA): UNDERSTANDING THE REASONS WHY THE DOMINICAN REPUBLIC (DR) JOINED THE CAFTA NEGOTIATIONS.

by

Danny J. García Rojas

June 2009

Thesis Advisor: Robert E. Looney
Second Reader: Harold A. Trinkunas

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13. ABSTRACT (maximum 200 words)

In 2004, the Dominican Republic joined the CAFTA negotiations, which had been started between the nations of Central America and the U.S. For the DR, this was a major step toward permanently opening up its domestic market and securing access to the markets of the other member nations. The main question that can be asked is, why would a small country like the DR choose to enter into a free trade agreement? Although it is possible to only look at the reasoning behind the specific decision, it is just as important to understand the domestic and international pressures the DR experienced over the last 35 years that influenced the preference. This thesis will examine the DR's choice through the overall framework of regionalization and how that influenced a proliferation of preferential trade agreements throughout the Western Hemisphere. The DR's economy has always been closely linked to the U.S.'s influence and policies, and specific changes in the global economic climate drove both nations to seek strategic partnerships with each other. The DR has had to make major adjustments to take advantage of potential economic opportunities, and this thesis concludes that the DR-CAFTA can be seen as a continuation of those efforts.

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NAVAL POSTGRADUATE SCHOOL
June 2009

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ABSTRACT

In 2004, the Dominican Republic joined the CAFTA negotiations, which had been started between the nations of Central America and the U.S. For the DR, this was a major step toward permanently opening up its domestic market and securing access to the markets of the other member nations. The main question that can be asked is, why would a small country like the DR choose to enter into a free trade agreement? Although it is possible to only look at the reasoning behind the specific decision, it is just as important to understand the domestic and international pressures the DR experienced over the last 35 years that influenced the preference. This thesis will examine the DR's choice through the overall framework of regionalization and how that influenced a proliferation of preferential trade agreements throughout the Western Hemisphere. The DR's economy has always been closely linked to the U.S.'s influence and policies, and specific changes in the global economic climate drove both nations to seek strategic partnerships with each other. The DR has had to make major adjustments to take advantage of potential economic opportunities, and this thesis concludes that the DR-CAFTA can be seen as a continuation of those efforts.

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TABLE OF CONTENTS

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LIST OF FIGURES

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LIST OF TABLES

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I. THESIS OVERVIEW

A. INTRODUCTION

In 2007, after several years of negotiations with Congress, the business sector, and other important players on the national stage, the Dominican Republic (DR) had implemented all the requirements needed to conform to the provisions of the Dominican Republic-Central America Free Trade Agreement (DR-CAFTA). For the DR and the Central American (CA) nations that had agreed to join in the agreement, this was a significant step in trying to link their economies to the ever-increasingly globalized market. For the countries of Guatemala, El Salvador, Honduras, Nicaragua, Costa Rica, and the Dominican Republic, the new accord with the U.S. was intended to eliminate tariffs and trade barriers and expand regional opportunities for the workers, manufacturers, consumers, farmers, ranchers and service providers in all the countries.[1] Although each nation had their reasons for joining the concerted effort, the central theme investigated throughout this thesis will be the DR's specific motivation for entering into the preferential trade agreement/arrangement (PTA).[2]

The focus of the proposed thesis will be to analyze why the DR was incorporated into the CAFTA process that was started in 2003. Did the U.S. initiate the inclusion, or did the DR want to be part of the collective agreement before it lost any of the comparative advantages it has managed to gain up to that time? In the end and through numerous difficulties, the DR accepted, ratified, and implemented the terms of the CAFTA provisions, but it is important to look at the path the nation took to arrive at that conclusion. The main research question that will be answered is what were the major reasons that prompted the DR to join the DR-CAFTA? It is also be important to look at a series of secondary questions that will help answer the primary question. What are the

[1] Office of the U.S. Trade Representative, *DR-CAFTA Final Text*, http://www.ustr.gov/Trade_Agreements/Bilateral/CAFTA/CAFTA-DR_Final_Texts/Section_Index.html (accessed May 28, 2009).

[2] Preferential Trade Agreements or Arrangements (PTAs) are sometimes grouped together as regional integration agreements. PTAs in this thesis can refer to a combination of free trade areas (FTAs), customs unions, common markets, and economic unions.

advantages and disadvantages of the DR entering in this agreement? What were the difficulties faced by the DR in meeting the provisions of the agreement? What challenges will be faced in order for the nation to take advantage of the new opportunities? What path did the DR take in preparation to join the PTA? Was the DR-CAFTA signed under the context of a broader type of integration effort? Will the DR-CAFTA ultimately improve the overall economic conditions of the DR?

B. IMPORTANCE

The research question is important, because it will provide insight into what the circumstances and conditions were that induced a small country like the DR to open itself up to free markets and trade. The obvious expectation of open markets is that unrestricted competition will result in increased efficiency, while producing competitive products and services that help the economy to grow. It is important to understand, from an economic standpoint, what the DR and similar nations hope to gain when they join comparable agreements. Although economic issues are the main focus of PTAs, they also have the ability to influence others parts of the national structure such as labor practices, laws, and institutions. It is important to determine where those changes occur. It is also possible to take the case of the DR and look at some of the issues that can result when other nations choose to enter into similar PTAs. The insight can be very valuable in light of the proliferation of PTAs over the last two decades.

During the mid 1990s, the U.S. and many Latin American nations started to look at the idea of establishing a Free Trade Area of the Americas (FTAA), which was a proposed agreement to reduce and eliminate tariffs throughout the entire Western Hemisphere. In many ways the concept of the FTAA was a natural extension of the liberal economic and stabilization policies that were instituted throughout Latin America in the late 1980s. The period before the reforms was characterized by a lack of bureaucratic competence, extractive capacity, international backing, and control of economic affairs; Latin American nations were looking for new ways to energize their economies, and free trade and open markets provided an alternative economic path.[3] Many advocates of the FTAA looked at the North American Free Trade Agreement (NAFTA), which opened up the markets of the U.S., Canada, and Mexico, as the initial starting block to economic transformation. Many proponents of the Washington Consensus believed that similar PTAs like the NAFTA could enable the poorer nations of the hemisphere to close the gap between the rich and poor.[4]

Unfortunately, a model similar to the European Union (EU) was a huge undertaking, and the motivation for the type of integration between what some considered the developed north and the developing south has not come close to becoming a reality. What has developed under the break down of the failed FTAA construct is a series of PTAs between the U.S. and various nations, either on a bilateral or multilateral basis, that are intended to build trading blocks within the region. [5] It was under this construct that the DR started to talk to the nations of the Central America Common Market (CACM) and the U.S. One of the agreements that came to fruition in the race for trading blocks was the DR-CAFTA, which was signed on August 5, 2004. As with any negotiation there were numerous concessions made by both parties, but in the case of joining the CAFTA, the Dominican leadership must have perceived that the advantages would outweigh the negative effects.

C. PROBLEMS AND HYPOTHESES

In conducting this research as to why the DR entered into the CAFTA, there will be several issues and problems presented. First it is important to understand the structures and problems associated with the DR's economy. The 1970s are a good starting point, because the DR's economy faced specific difficulties related to the country's inability to service its debt; these difficulties led the nation to conduct major structural adjustments in order to adjust to the changing global conditions.[6] Many of the

[3] Jorge Dominguez and Michael Shifter, eds., *Constructing Democratic Governance in Latin America*, 2nd ed. (Baltimore, MD: John Hopkins Press, 2003), 80.

[4] Moises Naim, "Washington Consensus or Washington Confusion," *Foreign Policy* 118, (2000): 93.

[5] Michael Reid, *The Forgotten Continent* (New Haven: Yale University Press, 2007), 296.

[6] John T. Cuddington and Carlos Asili, "Fiscal Policy, the Current Account and External Debt Problem in the Dominican Republic," *Journal of Latin American Studies* 22, no. 2 (May 1990): 350.

issues encountered were part of legacy systems that dated as far back as the Gen. Rafael Trujillo Era, which lasted from 1930 to 1961. The DR also experienced a fundamental economic shift from the dominance of the traditional agricultural exports, such as sugar, coffee, cocoa, and tobacco, to a more diversified economy that expanded due to tourism and free-trade zones (FTZs).[7] The latter shift helped to produce rapid economic growth during the 1990s, but it also exposed the nation to global trends. Economic growth was also aided by a major increase in other factors such as remittances and several market friendly economic reforms enacted by President Leonel Fernández in the late 1990s.[8]

One of the major sectors within the FTZs that experienced growth, but also faced significant problems, was the apparel industry. The U.S. and the eventual DR-CAFTA nations started a unique relationship during the 1980s with the passage of the Caribbean Basin Economic Recovery Act (CBERA). The U.S. encouraged growth in light manufacturing, especially in apparels that used components and textiles originating in the U.S. As part of the Caribbean Basin Initiative (CBI) the exports were eligible for unilateral preferential treatment, and this helped to establish a strategic partnership between the Caribbean nations and the U.S. The initiative was not only intended to help the Caribbean economies, but also was a response to similar PTAs that were springing up all over Asia. Asian countries, especially China, started to take a significant portion of international and U.S. textile and apparel business.[9] The DR's FTZs also started to come under increased competitive pressure in the late 1990s from Central America and China. It was during this time that the DR had to start looking for different ways to maintain any comparative advantage it had, especially after the expiration of global textile quotas on December 31, 2004. The removal of textile and apparel quotas caused many companies to shift production from the DR to nations with cheaper wages and more efficient production practices, such as China. It is expected that the DR-CAFTA will provide the

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[7] Federal Research Division, Library of Congress, *Country Studies: Dominican Republic,* *http://lcweb2.loc.gov/frd/cs/dotoc.html* (accessed June 8, 2009).

[8] Claire M. Ribando, U.S. Foreign Affairs, Defense, and Trade Division, Congressional Research Service, *Dominican Republic: Political and Economic Conditions and Relations with the United States*, April 17, 2007, 4.

[9] J.F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The Dominican Republic-Central America-U.S. Free Trade Agreement (DR-CAFTA),* January 3, 2005, 5.

conditions that will help the country maintain a good portion of its current apparel business and attract further foreign direct investment (FDI).[10]

Another major problem the DR faced was a major economic crisis from 2003-2004. This was caused by the combination of a banking scandal and mismanagement during the administration of President Hipólito Mejía. During that period the government decided to bailout the nation's third largest bank, *Banco Intercontinental* (*Baninter*), which had collapsed due to weak banking regulations, embezzlement, and fraudulent accounting. The government's decision proved to be a costly one that set off a chain of events that caused two other banks to collapse. It also led to the devaluation of the Dominican peso (DOP), the doubling of their external debt, and a loss of 20% of the gross domestic product (GDP). Pres. Mejía's government was forced to sign two International Monetary Fund (IMF) agreements during a two-year period, which eventually amounted to US$670 million and was used to strengthen the Central Bank's reserve position and balance of payments. For the DR the crisis was a major setback, but it forced the government to improve supervisory practices and to strengthen the regulatory framework, which included the adoption of consolidated accounting and supervision.[11] These reforms have paved the way for the gradual restoration of much needed public and international confidence in the financial sector, which will be essential if the DR is to take advantage of the benefits of the DR-CAFTA.

Lastly, it is important to look at the difficulties faced by the DR during the negotiations of the treaty and the challenges faced by the country in order to come into compliance with the provisions. During the initial negotiations, one of the major issues that the DR faced was how to protect itself from imported U.S. beverages that contained high fructose corn syrup. Many Dominican farmers involved in the sugar industry were concerned that dropping the tax on the imported drinks could result in severe losses in the

[10] Claire M. Ribando, U.S. Foreign Affairs, Defense, and Trade Division, Congressional Research Service, *Dominican Republic: Political and Economic Conditions and Relations with the United States*, April 17, 2007, 4.

[11] Jules Stewart, "Dominican Republic- Back in the Black, " *The Banker* , September 1, 2007.

local market.[12] Although the PTA didn't face as much controversy as it did in Costa Rica and Guatemala, there were several problems during the implementation phase. The Dominican Congress was able to ratify the treaty in September 2005, but meeting all the necessary conditions took until March 1, 2007. Some observers indicated that the DR government was trying to get exemptions related to special interest groups, while the Ministry of Trade spokesperson claimed the U.S. was being too strict in interpreting certain provisions.[13]

In looking at the preliminary data there is good reason to believe the leaders of the DR became convinced that the only way the country could maintain continued levels of growth was to integrate it into the regional shift that was occurring. Joining the CAFTA negotiations allowed the nation to permanently secure access to the main market where its exports were already going. The U.S. is by far the DR's biggest trading partner, and logical or not, this seemed to be the only guarantee for economic growth. The DR was already feeling the negative effects of growing competition, even from its CA counterparts, and they understood that delaying an entry into a subregional PTA would negatively affect any preferential treatment of its products and services into the U.S. It might have been possible to negotiate a stand-alone PTA with the U.S., but the DR-CAFTA also gave the DR greater access to the CA markets. The DR had already had its own agreement with the CACM nations, but single bilateral treaties would have restricted certain trade flows. A possible hypothesis is that the DR weighed the consequences of being left out of the negotiations, and realized it had to join the PTA or face major losses and shifts of FDI and jobs to other nations including the CAFTA signatories.

D. LITERATURE REVIEW

In an attempt to understand the specifics related to the DR's inclusion into the DR-CAFTA, it is valuable to step back and examine the literature related to the previous factors, agreements, and conditions that lead to the DR's decision to join the PTA. First,

[12] Tania Polanco, "EEUU rechaza impuesto de Republica Dominicana a bebidas edulcoradas," *El Nuevo Día*, December 6, 2004.

[13] John McCarthy, "Dominican Republic: Free Trade-Dismantling Barriers," *Foreign Direct Investment*, February 2007.

it is helpful to examine the proposed FTAA initiative and the conditions that led to the formation of individual and subregional PTAs. Second, an exploration of the DR and its specific links to the CACM, the Caribbean Community (CARICOM), and the CBI gives good insight as to the process of trade integration in the Caribbean Basin. It is important to get a sense of how trade and preferential treatment status started to develop in the Caribbean Basin in order fit the DR into the overall framework on which it stands today. Next, it is important to clarify the DR's economic transition since the 1970s, and the problems it has faced along the way. This includes the issues it faced to become eligible for the DR-CAFTA status. Lastly, the research will look at the literature that considers the potential expectations and consequences of the FTA on the DR.

In an attempt to understand the numerous FTAs that exist in the Western Hemisphere, like the DR-CAFTA, several authors have looked at overall trade integration throughout the Americas. Patrice Franko and M. Angeles Villarreal have come to the conclusion that Latin America's overall quest for development during the last 20 years has taken a path from the inward-looking approach to an outwardly oriented model. Initially nations began opening their trade and markets as a major part of the structural reform process that began in the 1980s. The Latin America nations began the transition process unilaterally, but by the mid 1990s many countries began to take a more regional approach to liberalization. Franko and Angles Villarreal believe that the regional approach allowed countries to achieve economies of scales, while giving them the ability to attain more than what was possible at the unilateral and multilateral levels.[14]

The major question of integration during the mid 1990s was whether the established subregional and bilateral agreements could be the building blocks of an overall regional agreement? When the original FTAA trade talks were started in 1998, it was perceived that the previous agreements could be used to build on and complement the entire process. Franko agrees that some felt that this was a good approach, and the MERCOSUR (The Southern Common Market) nations, led by Brazil, took the position

[14] Patrice Franko, *The Puzzle of Latin American Economic Development* (Lanham: Rowan & Littlefield Publishers Inc., 2007), 236.

M. Angeles Villarreal, U.S. Foreign Affairs, Defense, and Trade Division, Congressional Research Service, *Trade Integration in the Americas*, November 22, 2005, 4.

that markets should be opened gradually, while allowing nations to build up import-competing business.[15] Franko also presents a negative aspect that states subregional blocks can be trade diverting. Antoni Estevadeordal and Kati Suominen agree with Franko's observation, but frame the argument with the complications that have come about from multiple and overlapping agreements. The latter authors feel that PTAs can introduce policy friction that increases trading and transaction costs to nations dealing on two or more PTA fronts simultaneously.[16] Estevadeordal and Suominen believe that the PTAs have the ability to serve as building blocks for the FTAA, if they are designed on the basis of the NAFTA model and if the rules of origins of each treaty can be harmonized based on establishing a hemispheric cumulation zone.[17]

Many of the more recently established PTAs, like DR-CAFTA, have used the NAFTA as their reference point, and it is hoped that they will provide the blueprint of the potential FTAA. Emilio Pantojas García believes that the announcement of the FTAA created a push in the entire hemisphere to liberalize bilateral and regional trade and accelerated the integration process of established entities like the CARICOM and CACM. He also notes that although advances on the economic front were made, there were major problems on the political level, which have prevented regional integration from becoming a reality.[18] Michael Reid criticizes the PTAs claiming that they are just preferential deals, and many Latin American nations are settling for third best trading options. Reid also states that a PTA like DR-CAFTA is far less beneficial than a global trade deal, and he agrees in MERCOSUR's perspective that a united Latin America in the FTAA would have more bargaining power with the U.S.[19] As of 2005 there was a major rift between the 34 nations that wanted the FTAA negotiations to resume and the five nations that refused, which included the MERCOSUR nations and Venezuela. What has occurred in

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[15] Patrice Franko, *The Puzzle of Latin American Economic Development* (Lanham: Rowan & Littlefield Publishers Inc., 2007), 273.

[16] Antoni Estevadeordal and Kati Suominen, "Rules of Origin in Preferential Trading Arrangements: Is All Well With the Spaghetti Bowl in the Americas?" *Economía* 5, no. 2 (2005): 64.

[17] Ibid., 87 & 91.

[18] Emilio Pantojas Garcia, "Economic Integration and Caribbean Identity: Convergences and Divergences," *Caribbean Studies* 36, no. 1 (2008): 61.

[19] Michael Reid, *The Forgotten Continent* (New Haven: Yale University Press, 2007), 297.

parallel to the unsuccessful talks has been the proliferation of blocks of PTAs among the participating nations. Many of the smaller nations and Mexico, each with strong connections to the U.S. market, resorted to establishing PTAs that would secure permanent markets for their exports and services in the face of global competition.

Although the FTAA would have culminated into a major regional trading entity, this was not the first attempt by nations in the hemisphere to try to integrate into regional groupings. Pantojas Garcia notes that several efforts such as the CACM, the CARICOM, and MERCOSUR were initiated before the FTAA was proposed, but it has only been in the last two decades that the PTAs have become operational economic units.[20] The DR had previous PTAs with CACM, CARICOM, and the CBI, which had an influence on the DR's decision to join the DR-CAFTA. The revival of CACM in the early 1990s paved the way for integration for the nations of CA, but the CACM nations also decided to extend participation to other nations such as the DR, Panama, and Belize. In 1997, the leaders of the CACM nations meet in Santo Domingo, DR, to initiate the expansion of the Central American integration process; it was at this meeting that the participants decided to create a PTA between CA and DR.[21] The CA-DR FTA was the first PTA that the CA nations had signed with any nonmember nation, and it helped to establish important links to bring together the economies of the two parties.

Victor Bulmer-Thomas states that the goal of CACM was to shift from import substitution industrialization (ISI) to export lead growth based on non-traditional exports, and the opportunities created by the agreements similar to the CA-DR FTA would be a step in achieving that.[22] Leonardo Callejas, former president of Honduras, believes it was important for CA to reach out to its Caribbean neighbors in an attempt to establish partnerships for prosperity. Callejas was convinced that banding together and implementing adjustment policies was the way that the nations of the Caribbean Basin

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[20] Emilio Pantojas Garcia, "Economic Integration and Caribbean Identity: Convergences and Divergences," *Caribbean Studies* 36, no. 1 (2008): 55.

[21] Secretaría de Integración Económica Centroamericana, *Declaracion De Santo Domingo*, Santo Domingo, November 06, 1997.

[22] Victor Bulmer-Thomas, "The Central American Common Market: From Closed to Open Regionalism," *World Development* 26, no. 2 (1998): 320.

could meet the emerging demands of the global economy.[23] Callejas, Bulmer-Thomas, and a source from the Economist were also aware of the potential challenges that other PTAs such as NAFTA would have, especially with Mexico's ability to attract new trade and investment. The latter group believed that is was necessary to establish a bridging mechanism for the countries involved in CACM and the CBI in order to maintain the positive economic and political trends that started to take place in the 1990s.[24]

At the same time the DR was attempting to open up trade with CA, it also embarked on another initiative to gain access to the markets in CARICOM. In August of 1998 the DR signed a FTA with the CARICOM nations that would eventually come into force in 2001. The Secretariat of CARICOM specifically stated that globalization required fundamental changes in the economies and the development process of the Caribbean Region and increased the risk of marginalization for smaller and vulnerable economies.[25] The leaders of the DR hoped that the PTA would "help integrate the economies of the Caribbean Basin with the DR acting a bridge between CA and the Caribbean."[26] The signing of the DR-CARICOM FTA helped bring the Caribbean nations together. Winston Griffith argued that during the early 1990s the DR was a global platform that created intense competition for the CARICOM nations. Griffith emphasized the DR's attractiveness due to its cheap labor and its relatively inexpensive space in the FTZs; this comparative advantage was believed to be the cause of CARICOM not being able to take full advantage of the CBI. [27]

Interesting enough, the DR has been an observer of CARICOM since 1982 and had formally requested full membership into the bloc in 1991 and 2005. Sir Ronald Sanders believed that in 2005, CARICOM needed to consolidate their own internal economic

[23] Leonardo Callejas, "The Americas: Extend Free-Trade Accords Southwards," *Wall Street Journal*, January 31, 1992.

[24] Anonymous, "Trade in Central America: To NAFTA and EMU, a child," *The Economist,* July 17, 1993.

[25] Secretariat Caribbean Community, *The Statement of Santo Domingo-The Caribbean Encounter: Towards the 21st Century*, Georgetown, September 4, 1998.

[26] James Canute, "CARICOM in trade deal with Dominican Republic," *Financial Times,* August 24, 1998.

[27] Winston Griffith, "CARICOM Countries and the Caribbean Basin Initiative," *Latin American Perspectives* 17, no.1 (1990): 40.

arrangements, which would allow them to increase their competitive capacity. This was of extreme importance since CARICOM was in the process of establishing a Caribbean Single Market and Economy (CSME). The addition of any new members could complicate CARICOM's goals. Sanders also expressed apprehension about opening CARICOM to the DR's much larger market, which could potentially produce an overwhelming effect if not done gradually.[28] In 2008 Federico Cuello Camilo, DR ambassador to the EU, stated the DR was no longer interested in pursuing membership status in light of the DR-CARICOM FTA implementation record. Cuello Camilo told reporters that the DR would prefer to work with the mechanisms that were in place and work on further improvements.[29]

Although the DR and the Caribbean nations have worked hard to improve their economies, one of the major economic impacts that helped transform many of the nations has been the U.S.'s interest in the region through the CBI. Anthony Payne concludes that by using the CBI, the U.S. used a policy of "carrot and stick" with the Caribbean nations. The carrot was a nonreciprocal trade and aid program, and the stick was the structural adjustment packages imposed by the IMF and World Bank. For many of the countries facing major crises created by declining primary exports, lower number of tourists, balance of payments, and debt, there was no alternative but to accept the economic incentive.[30]

Griffith takes the general view that many CBI nations have achieved limited success is as a result of the detrimental internal conditions that existed in the nations themselves. Griffith observes that the DR was able to take advantage of the opportunities and by 1990 had become the world's largest non-Asian supplier of apparels to the U.S. market. The author notes the conditions that made the DR attractive to (FDI) in

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[28] Ronald Sanders, "Dominican Republic in CARICOM? Not Yet," *Caribbean Net News*, August 23, 2005, http://www.caribbeannetnews.com/2005/08/23/sanders.shtml (accessed June 10, 2009).

[29] Anonymous, "Dominican Republic not interested in CARICOM, " *Dominican Times*, December 13, 2008, http://www.dominicantoday.com/dr/economy/2008/12/13/30409/Dominican-Republic-not-interested-in-Caricom (accessed June 10, 2009).

[30] Anthony Payne, "The New Politics of 'Caribbean America,'" *Third World Quarterly* 19, no. 2 (1998): 210.

comparison to other CBI beneficiaries.[31] Herbert Jacobson's argument also presents the issues that have led to marginal advance, and emphasizes that the CARICOM's internal markets are too small to produce large quantities of any particular product, which could result in reduced overhead costs.[32] William Corbett Jr. takes the viewpoint that although the CBI was presented as a way for the Caribbean nations to achieve economic health; the reality was that free trade was the U.S.'s ultimate objective. Corbett believes that CBI was a wasted opportunity for the U.S. to genuinely help the in the economic revitalization of the Caribbean area due to several of the U.S.'s incorrect underlying assumptions and protectionism. He also acknowledges that many of the CBI beneficiaries started to feel the erosion of their comparative advantages when the NAFTA was enacted.[33] The latter condition would only worsen after the mid 1990s with the increased global competition, as the nations of the Caribbean would have to come up with different solutions to keep with the global demands.

In looking at the DR-CAFTA there are several sources that provide insight as to how the PTA was initiated and the issues surrounding it. J.F Hornbeck provides two important documents that explain U.S. trade relations with the DR and CA, a review of the major sectors and issues of the PTA, and an outlook for the PTA. Hornbeck understood that the DR-CAFTA was controversial to several sectors of the nations' economies and notes how labor rights issues in some of the Latin American nations caused organized labor to protest the agreement. Hornbeck looks at how the PTA changed the framework from the unilateral CBI to the compromises reached with the bilateral agreement. He does take the view that DR-CAFTA is a comprehensive and

[31] Winston Griffith, "CARICOM Countries and the Caribbean Basin Initiative," *Latin American Perspectives* 17, no.1 (1990): 41.

[32] Herbert L. Jacobson, "The Americas: False Promises of the Caribbean Basin Initiative," *Wall Street Journal*, April 4, 1986.

[33] William Corbett Jr., "A Wasted Opportunity: Shortcomings of the Caribbean Basin Initiative Approach to Development in the West Indies and Central America," *Law and Policy in International Business* 23, no. 4 (1992): 951.

innovative agreement that melds the interests of U.S. with the Latin American nations.[34] The Washington Office on Latin America (WOLA) put together an educational briefing package from eight organizations covering DR-CAFTA subjects that range from transparency and participation in the negotiations to lessons learned from the NAFTA. The overall premise of the package is to determine if the PTA was a fair deal for the Latin American nations by describing the key issues and perspectives that frame the debate.[35] Another study by M. Ayhan Kose, Alessandro Rebucci, and Alfred Schipke looks at the macroeconomic effects of the DR-CAFTA. The latter authors also analyze the implications of the agreement by looking at NAFTA, since both PTAs are based on common precepts. They conclude that the PTA will play a major role in decreasing macroeconomic volatility in the region, while the synchronizing businesses cycles and increasing cyclical interdependence through trade and financial flows. Although shocks originating in the U.S. will become a more prominent feature driving macroeconomic changes, these are expected to be less volatile than the variations that have come from the region.[36]

Jessica Todd, Paul Winters, and Diego Arias provide a conceptual framework that identifies policies and programs for the short and middle term that will help the rural sector attain the potential benefits of the DR-CAFTA. For the DR-CAFTA nations, the eventual effects of trade liberalization will have a major impact on agriculture, which remains a principal activity for many people in Latin American nations. It will be important for the countries to actively look for niche markets in nontraditional exports in order to alleviate the losses they will experience in their traditional products. Like the WOLA package, it looks at the lessons learned from the NAFTA to try to provide

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[34] J.F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The Dominican Republic-Central America-U.S. Free Trade Agreement (DR-CAFTA),* January 3, 2005, 32-33.

J.F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The U.S.-Central America Free Trade Agreement (CAFTA): Challenges for Sub-Regional Integration,* June 1, 2004, 29.

[35] Washington Office on Latin America. Latin America Working Group. "Fair Trade or Free Trade? Understanding CAFTA*,"* December 2003, 18, http://www.wola.org/media/Rights%20and%20Development/cafta_briefing_packet_final_dec03.pdf (accessed June 10, 2009).

[36] M. Ayhan Kose, Alessandro Rebucci, and Alfred Schipke, International Monetary Fund, "Macroeconomic Implications of CAFTA-DR," in *Central America: Global Integration and Regional Cooperation, Occasional Paper 243*, July 2005, 31-32.

solutions to the problems that will arise.[37] Michael Fielding looks at the DR-CAFTA through an analysis of how small and medium businesses can profit from the arrangement and help provide consumers in the DR and CA with more products and options. Fielding believes that the opened markets, although not large, are reliable and stable. The latter facts along with the streamlining of processes, lowering of costs, and increased transparency can lead to higher standards of living.[38]

Assessing the issues related specifically to the Dominican economy is very important in order to understand the circumstances that led to the signing of the DR-CAFTA. Frank Moya Pons takes a critical look at the negative economic policies that the presidents of the DR used during the 1980s. The country faced what Moya Pons calls an economic dictatorship under President Joaquin Balaguer (1986-1996), who in his first term abandoned all the free-market principles that took place earlier in the 1980s and lead a major campaign to expand government control. The economic policies led to major monetary chaos, inflation, debt, and rampant corruption.[39] John Cuddington and Carlos Asilis look at the structural problems concerning fiscal policy and conclude that they were a major cause of the DR's deficits during the 1980s. The authors agree that public sector spending led to external borrowing, which resulted in major debt problems. They conclude that more restrictive budgetary policies, and change in the archaic tax system would have helped the situation significantly.[40] The 1990s was a period of growth and transformation for the DR economy, and P. Young and others outline the reforms that took place, which combined with other factors helped produce a period of extended

[37] Jessica Todd, Paul Winters, and Diego Arias. Inter-American Development Bank, "CAFTA and the Rural Economies of Central America: A Conceptual Framework for Policy and Program Recommendations," December 2004, 1-2.

[38] Michael Fielding, International Marketing, "CAFTA-DR to build options over time," *Marketing News*, February 1, 2006, 13.

[39] Frank Moya Pons, *The Dominican Republic: A Natural History* (New Rochelle: Hispaniola Books, 1995), 427.

[40] John T. Cuddington and Carlos Asilis, "Fiscal Policy, the Current Account and the External Debt Problem in the Dominican Republic," *Journal Latin American Studies* 22, no. 2 (May 1990), 332.

growth. The comprehensive IMF study shows how the DR came into alignment with the foreign exchange market and the steps the nation needed to implement for further trade liberalization and modernization.[41]

As mentioned previously, the transformation brought many changes for the economy, but entering the open market also caused certain problems. The DR had to constantly look for ways to maintain its competitiveness. J.F. Hornbeck explains the problems the DR-CAFTA nations started to face at the end of the 1990s and the effects of the Agreement on Textiles and Clothing (ATC). Hornbeck's conclusion that the PTAs being negotiated became a strategic effort to preserve gains in response to what other countries were doing is quite valid.[42] Erika Morphy believes that the PTA was necessary, and without it textile investment and sourcing in the region would have transferred to the Chinese market. She further states that the advantages of this agreement will be that investment by U.S. companies and other DR-CAFTA nations will increase once the protection and opportunities are in place.[43]

Karen Thuermer analyzes the deep changes that the DR must make in order to comply with provisions of the PTA, especially in light of the loss of revenues the DR government will experience when import tariffs are dropped. Thuermer presents a balanced report with input from many interested sectors both on the Dominican and American sides of the issue. Thuermer also looks at the DR's banking sector and the importance of instilling confidence in this sector, which will aid in attracting FDI and new business. Her analysis was done with the background of the 2003-2004 banking crisis. [44] Jules Stewart also highlights the DR's 2003-2004 economic crisis and looks at the recovery efforts and reforms needed to take advantage of the DR-CAFTA. She feels

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[41] P. Young and others, International Monetary Fund, "Dominican Republic: Selected Issues," October 1999, http://www.imf.org/external/pubs/ft/scr/1999/cr99117.pdf (accessed June 10, 2009).

[42] J.F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The Dominican Republic-Central America-U.S. Free Trade Agreement (DR-CAFTA),* January 3, 2005, 4-5.

[43] Erika Morphy, "Dominican Republic: US trade-One by One," *Foreign Direct Investment*, December 2005.

[44] Karen E. Thuermer, "Dominican Republic: DR-CAFTA-Joining the CAFTA Club," *Foreign Direct Investment*, December 2005.

Karen E. Thuermer, "Dominican Republic-Financial Services-Free Money," *Foreign Direct Investment*, December 2005.

that the DR has come a long way, but still needs to address serious issues such as tax evasion, educational gaps, and the strengthening of institutions.[45] The Latin Finance takes the stand that the DR-CAFTA will transform the economic landscape of the signatories for many years, and without it the region was likely to face an economic disaster. The article specifically details how the PTA will accelerate the area towards specialization. Each country is looking to find areas where it has specific advantages, but the Latin Finance states that the largest challenge the PTA will face will be the management of expectations. The key the argument is that the DR-CAFTA provides more opportunities for the nations, but each nation has to make sure that each of its sectors is implementing the reforms needed to take advantage of the situation.[46] Overall there are many sources that relate the issues the DR has faced in the past, and the decisions that have been made by the government and other national sectors to manage the dynamic economic global forces.

E. METHODS AND SOURCES

The main analytic approach that will be taken to answer the research question will be a historical study. Looking at several PTAs such as the FTAA, CACM, CARICOM, and CBI, will help to assess how they changed due to internal and external factors. Each organization will first be analyzed independently and then will be linked into the DR's economy. It is important to look for the crucial changes in order to find out how their progressions or transformations are related to the DR's economy. It is quite clear that the named entities have helped shape the DR's posture in its attempts to link itself to larger regional and global market. They all directly tie into the DR's decision to join the DR-CAFTA. One of primary sources that will be used is *The Devil Behind the Mirror,* by Steven Gregory, which describes the phenomenon of globalization on the DR during the

[45] Jules Stewart, "Dominican Republic-Recovery Efforts Come to Fruition," *The Banker*, September 1, 2007.

Jules Stewart, "Dominican Republic-Recovery Ripples," *The Banker*, September 1, 2007.

[46] Anonymous, "The Challenge of CAFTA," *Latin Finance*, September 2005.

first half of the current decade. The chapter dealing with FTZs and transnational capital is important in understanding the economic change that occurred in the DR.[47]

In comparison to the other CA nations, except Costa Rica, there was significant delay from the time the DR signed the treaty and the DR Congress ratified it. There was also a significant time lag from when the PTA was ratified by the DR Congress and when the PTA went into force. It is important to look into these gaps to determine what problems were faced and how they could potentially affect the nation in the future. Overall much has been written about the controversial issues involving Costa Rica accepting and implementing the PTA, but not much outside the DR was written related to the issue. The DR newspapers *Listín Diario* and *El Nacional* help to bridge the mentioned gaps and give a good perspective from the Dominican point of view regarding the DR-CAFTA process worked and the its preliminary results. Other Spanish language newspapers such *La Nacion* and *El Financiero* from Costa Rica and *El Nuevo Día* from Puerto Rico provide insight from a Latin American aspect. Two other important sources that have been used are the IMF page and the Organization of American State's Foreign Trade Information System (SICE), which centralizes information on trade policy in the Americas. The SICE page is extremely useful because it provides official documentation relating to each county's trade agreements.

F. THESIS OVERVIEW

This thesis will be organized into four chapters. Chapter I began with an introduction outlining the main research question followed by the any problems, issues, and secondary research questions that are necessary to answer the main research question. A major part of Chapter I consisted of a literature review to help clarify what has been written related to the primary and secondary research questions, and the problems and issues involved with them. This was followed by a survey of additional primary sources and concluded with a thesis overview. Chapter II will be dedicated to looking at the potential FTAA, which is the overarching framework to which the other PTAs (CBI, CACM, CARICOM) are connected. Although some of the PTAs that will be

[47] Steven Gregory, *The Devil Behind the Mirror* (Berkeley: University of California Press, 2007), 10.

discussed were established before the idea of the FTAA became concrete, they developed even further after the breakdown in negotiations and were supposed to be the building blocks of the overall regional agreement. This chapter helps to establish the links between the listed PTAs and the DR, while building the foundations needed to show why the joining the DR-CAFTA became a logical step in the DR's economic evolution. It also focuses on the external entities that played a role in the final outcome.

Chapter III will cover the overall transformation of the DR economy starting from the problems that occurred during the 1970s. The chapter will analyze the impacts of restructuring and the neoliberal reforms that allowed the DR economy to grow in the 1990s. These same measures opened the DR up to global market forces and forced the country to look for ways to remain competitive. This chapter will explain the impacts that China, Asia, and WTO regulations have had on the light manufacturing sectors of the DR, CA, and the U.S. It will also detail how the DR made attempts to establish closer ties to the subregional arrangements in which it was already involved. The next major event examined will be the financial crisis of 2003-2004, which occurred around the same time the DR started to talk to the U.S. concerning a potential PTA. It will be necessary to look at this event because, the steps needed to recover from the major shock were important to set the nation up for serious talks with the U.S. and CA. This chapter is mainly focused on internal factors dealing directly with the DR's quest to find where it would fit into the larger global picture.

The final chapter will give an overview of the DR-CAFTA and then look at the how the negotiation process evolved for the DR. It will outline the difficulties encountered during the negotiation, ratification, and implementation phases. It will explore what the expected gains and losses were in the major sectors of the economy. It will also be important to look into the challenges that the DR will continue to face in order to take full advantage of the FTA. This chapter will also examine the preliminary results of the implementations in order to get some idea of how issues have evolved since the treaty was put into force on March of 2007. This latter analysis will be limited to the first year after the enforcement, so that the current global recession does not skew the analysis.

II. THE DOMINICAN REPUBLIC AND ITS TIES TO WESTERN HEMISPHERE REGIONALIZATION

A. INTRODUCTION

In an effort to understand the numerous reasons why the Dominican Republic (DR) joined the Central American Free Trade Agreement (CAFTA) negotiations, it is beneficial to look at the overall framework of how regionalization and other subdivisions aided the trade liberalization process in the Western Hemisphere. For the purposes of this study, regionalization will refer to the overall Western Hemisphere integration process, while subregionalization will refer to the initiatives of the smaller blocs within the larger region. The DR-CAFTA is one of the latest preferential trade agreements or arrangements (PTAs)[48] that have been signed. It is clear also that it is the latest link in a chain of accords designed to open the entire region to the global economy.

There have been multiple attempts throughout the years to achieve increased levels of trade cooperation in the region, but the process of integration became more realistic as the countries in the Americas started to seriously open up their economies to free trade by the 1980s. This chapter will specifically focus on the influential PTAs to which the DR was connected and how those PTAs helped to guide the country down a path of economic evolution. Several questions need to be answered here. First, what were the origins and goals of these agreements? Next, how did these PTAs change over time (with an emphasis on how they attempted to tie their products and services to the global market)? What has been the relationship between the PTAs and the hoped for, but unrealized, Free Trade Area of the Americas (FTAA)? Also, how did the DR become involved with the different PTAs, and finally to what extent did the DR establish formal relationships with the existing organizations?

The overarching PTA that will be the analyzed is the FTAA initiative, which was initially intended to supersede and replace all other PTAs in effect. The analysis will explore the origins and motives behind this enormous undertaking, as well as the

[48] Preferential Trade Agreements or Arrangements (PTAs) are sometimes grouped together as regional integration agreements. PTAs in this thesis can refer to a combination of free trade areas/agreements (FTAs), customs unions, common markets, and economic unions.

fundamental interpretation of how subregional blocs would fit into the grand scheme of the negotiations. From there the chapter will look at the subregional PTAs in which the DR was involved within the Caribbean Basin, before it opted for membership in the CAFTA. The latter research will include the Central America Common Market (CACM) and the Caribbean Community (CARICOM). CACM and CARICOM were both originally established with similar goals in mind during the 1960s and 1970s, when attaining higher levels of internal industrialization was viewed as an essential part of their incipient developmental strategies. The DR was not a part of CARICOM and CACM when they were started, but became involved with them as the blocs started to look for other opportunities to expand trade and connect the entire Caribbean. Lastly, an examination of the Caribbean Basin Initiative (CBI) will provide significant insight into how the entire Caribbean Basin was affected by the unilateral PTA with the U.S. The CBI can almost be seen as the underlying PTA that transformed significant portions of the beneficiary nations' economies away from primary product exportation and towards the creation of the light-manufacturing sector. The CBI linked the nations of the Caribbean more closely to the economy of the U.S., but also introduced the Caribbean nations to the pressures of competition from other parts of the world, particularly China and Asia.

B. FREE TRADE AREA OF THE AMERICAS (FTAA) INITIATIVE

By the end of the 1980s, major economic changes had swept across Latin America. After suffering through a decade of pervasive cheating, where state and local actors continuously tried to evade the mounting economic crises by cheating each other and consuming public assets, there was a significant shift in thinking as to how economic stabilization could be achieved. Many Latin American nations were left with few options and implemented significant market-oriented programs of economic stabilization and structural adjustment.[49] The dominant economic model of the 1990s emphasized

[49] Jorge Dominguez and Michael Shifter, eds., *Constructing Democratic Governance in Latin America*, 2nd ed. (Baltimore, MD: John Hopkins Press, 2003), 80.

neoliberal reform and trade fundamentalism as the key components needed for growth.[50] At the same time, and with investments in the area, the U.S. started to take a turn towards regionalization. In 1990, President H.W. Bush laid out the U.S.'s new approach and unveiled the major concepts of the Enterprise for the Americas (EAI) that focused on the "three pillars," which were trade, investment, and debt. The key goals of the EAI were to promote increased economic interaction by establishing a hemispheric free trade zone, adopting measures to create new capital flows in the region, and taking new approaches towards debt that established favorable investment environments. It was hoped the EAI would establish a united and democratic hemisphere with equal trading partners "stretching from the port of Anchorage to the Tierra del Fuego."[51]

The EAI offered a new economic vision that was full of promise, but not all parties concerned shared the same optimistic perspective. Specifically, the EAI led many leaders in the Caribbean Basin to express justified concerns about the potential erosion of the preferential trade treatment that had been established by the Caribbean Basin Initiative (CBI). Many contended that despite the duty-free access of many products from the region to the U.S., many sectors would be further disadvantaged by the open trade regime.[52] Despite some of the negative aspects the EAI did succeed in establishing the foundation needed to create the North American Free Trade Agreement (NAFTA). The endeavor that the U.S., Canada, and Mexico undertook sent a strong signal to the rest of the region concerning the extent of commitment behind the principles of the EAI. The EAI was also important because it promoted a series of other programs, discussions, and

[50] Emilio Pantojas Garcia, "Economic Integration and Caribbean Identity: Convergences and Divergences," *Caribbean Studies* 36, no. 1 (2008): 60.

[51] George H. W. Bush, "Remarks Announcing the Enterprise of the Americas" (announcement, East Room, White House, June 27, 1990). http://www.presidency.ucsb.edu/ws/index.php?pid=18644 (accessed June 10, 2009).

[52] William Corbett Jr., "A Wasted Opportunity: Shortcomings of the Caribbean Basin Initiative Approach to Development in the West Indies and Central America," *Law and Policy in International Business* 23, no. 4 (1992): 951.

agreements that went beyond the original three pillars and attempted to address other endemic problems, such as drug-trafficking, migration, and the institution building needed for effective democratization.[53]

In 1994 the nations of the Western Hemisphere sought to build upon and deepen the thrust created by the EAI and announced the FTAA initiative at the first Summit of the Americas. It was at this monumental meeting held in Miami that the leaders of the 34 nations agreed to negotiate a Western Hemisphere free trade agreement (FTA) by 2005. The new initiative would fuse the PTAs that existed and would join the $13 trillion of services and products with its nearly 800 million inhabitants.[54] Although this colossal undertaking would require extensive negotiations, it is evident that the expected outcome was an area where the rules of trade would be simplified in the long term. Estevadeordal and Suominen examine the issues and complications that have come about with the proliferation of PTAs in the Western Hemisphere since the FTAA was initially announced. They conclude that the "hemispheric PTA spree has forged a veritable spaghetti bowl of multiple and overlapping agreements…each PTA's standards, safeguards, government procurement, and investment - entangle the bowl further."[55] The new PTAs, especially those modeled after NAFTA, carry rules of origin that actually counteract PTA inspired trade liberalization.[56] By establishing the FTAA, problems and friction arising from overlapping and conflicting agreements will hopefully be removed, and products and services will be able to flow throughout the region in an more efficient manner.

The major question that came to the fore at the initial summit was what role the current and future subregional agreements would play in the formation of the FTAA? It is important to note that under the EAI the U.S. was willing to enter into bilateral agreements with individual countries or groups of nations that had associated for the

[53] Anthony Payne, "The New Politics of 'Caribbean America,'" *Third World Quarterly* 19, no. 2 (1998): 208.

[54] M. Angeles Villarreal, U.S. Foreign Affairs, Defense, and Trade Division, Congressional Research Service, *Trade Integration in the Americas*, November 22, 2005, 16.

[55] Antoni Estevadeordal and Kati Suominen, "Rules of Origin in Preferential Trading Arrangements: Is All Well With the Spaghetti Bowl in the Americas?" *Economía* 5, no. 2 (2005): 64.

[56] Ibid., 92.

purpose of trade liberalization.[57] In a sense some of the pieces of the hemispheric integration puzzle were already on the board, but they had yet to be organized in a manner that would help create a clear overarching framework. The initial declaration stated that one of it goals was to maximize market openness through high levels of discipline and to build upon existing agreements.[58] Some nations agreed that subregional blocs should be the foundation of the FTAA because it would allow them to negotiate as bigger entities throughout the process. The Southern Common Market (MERCOSUR) bloc, led by Brazil, was a strong proponent of the subregional approach and felt that trade liberalization should be a phased project. MERCOSUR believed that the gradual approach would allow nations to take the adequate measures needed to develop import-competing industries; this point of view would later morph with other factors and develop into a strategy that would seek to gain leverage during subsequent summit meetings. The U.S. sought to open trade with any democratic nation willing to do so and saw subregional and bilateral PTAs as a way to achieve greater liberalization and address issues not dealt with at the World Trade Organization (WTO) through the Doha Agenda.[59]

After several preliminary ministerial meetings that were used to examine the existing trade related measures and to establish the structure of negotiations, the formal process of creating the FTAA was initiated in April of 1998. The heads of state and ministers agreed that the final agreement would be balanced, comprehensive, in line with the WTO, and instituted in a single undertaking. It was also agreed that the process would be transparent and acknowledge the differences in the levels of development and size of the different economies so that all the nations could participate. Importance was placed on the goal of raising living standards, improving working conditions, and

[57] George H. W. Bush, "Remarks Announcing the Enterprise of the Americas" (announcement, East Room, White House, June 27, 1990). http://www.presidency.ucsb.edu/ws/index.php?pid=18644 (accessed June 10, 2009).

[58] First Summit of the Americas Action Plan, December 9-11, 1994, http://www.summit-americas.org/miamiplan.htm.

[59] Patrice Franko, *The Puzzle of Latin American Economic Development* (Lanham: Rowan & Littlefield Publishers Inc., 2007), 273.

protecting the environment.[60] The negotiators wanted to make concrete progress on the initiative by 2000, but significant development was partially prevented by the divergent interests that started to surface, particularly on the part of the members of MERCOSUR. The bloc affirmed that the consolidation of MERCOSUR, in relation to the U.S., would provide Latin America, as a whole, a better bargaining position during the negotiations.[61] Many of the issues that arose were due to the stalling of the Doha Round of world trade talks, which were supposed to liberalize trade in agriculture and eliminate subsidies for agricultural products. The U.S. insisted that it would not eliminate subsidies on a regional basis and would wait until a global agreement was reached; the South American nations, on the other hand, felt that the continued subsidies would provide the U.S. an unfair advantage in their markets, especially if the goal was to create a free trade zone.[62]

Another concern that started to resonate within the FTAA negotiations was that of which nations would be the leaders and take representative stands on issues throughout the complicated procedure? Although all the participating nations would be allowed to raise issues and contribute, it was almost inevitable that the economic and political giants of the hemisphere would rise to take their place within the structure. In the course of time, the leading actors would become the U.S. and Brazil, with Venezuela exerting particular pressure during the latter parts of the talks. Under President Luiz Inácio Lula da Silva, Brazil's external policies took a different turn, and starting in 2002 it demonstrated its desire to be seen not only as a regional power, but a global player as well. Many Brazilian diplomats went as far as to reject the entire FTAA initiative in favor a South American bloc that would be led by the increasingly important nation.[63]

In 2003 as the negotiations continued to stall, Brazil and the U.S. made a compromise on a two tier FTAA structure, dubbed FTAA-Lite. The compromise would establish a common set of rights and obligations for all the nations on the first tier. The

[60] Free Trade of the Americas, "Antecedents of the FTAA Process- Progress of the Negotiations, http://www.ftaa-alca.org/View_e.asp#STRUCTURE (accessed June 10, 2009).

[61] Patrice Franko, *The Puzzle of Latin American Economic Development* (Lanham: Rowan & Littlefield Publishers Inc., 2007), 276.

[62] Michael Reid, *The Forgotten Continent* (New Haven: Yale University Press, 2007), 297.

[63]Michael Reid, *The Forgotten Continent* (New Haven: Yale University Press, 2007), 309.

second tier would consist of a series of multilateral agreements in which the individual countries would voluntarily commit to make progress to achieve deeper disciplines and liberalization. Yet even with this new framework, the differences between the U.S. backed side on the one hand and the MERCOSUR bloc on the other hand, concerns over which areas would fall within each tier were not reconciled. The negotiations came to a complete halt in 2004 as the MERCOSUR block and Venezuela refused to continue the process.[64]

The breakdown sparked significant anti-FTAA momentum, both in the U.S. and in Latin America. Venezuela's President Hugo Chavez brought a new dimension to the discord. He actively promised to bury the FTAA and championed his own continental alliance known as the Bolivarian Alternative for Latin America and the Caribbean (ALBA). Although a further attempt was made to revive the FTAA initiative during a fourth Summit of the Americas held in Mar del Plata in November 2005, it was clear that the rift between the opposing sides had continued to grow. According to MERCOSUR and Venezuela, talks would not resume until the "necessary conditions" were met.[65] In the U.S. the FTAA also caused backlash from anti-globalization protestors and union activists who feared jobs would move to other areas, but the U.S.'s official stance to open up markets continued to march forward.[66]

It was evident by 2006 that the hemisphere was divided into two camps, but that didn't stop other initiatives from successfully occurring in parallel to the FTAA negotiations. Although the FTAA appeared to have been dying a slow and painful death, Mexico, Central America, the DR, and Chile made a commitment to open trade and investment by signing PTAs with the U.S. and with each other. Other countries like Colombia and Peru were also making serious attempts to access the U.S. market by entering into bilateral negotiations.[67] As global pressures on trade and investment

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[64] M. Angeles Villarreal, U.S. Foreign Affairs, Defense, and Trade Division, Congressional Research Service, *Trade Integration in the Americas*, November 22, 2005, 16.

[65] Michael Reid, *The Forgotten Continent* (New Haven: Yale University Press, 2007), 309.

[66] Patrice Franko, *The Puzzle of Latin American Economic Development* (Lanham: Rowan & Littlefield Publishers Inc., 2007), 276.

[67] Michael Reid, *The Forgotten Continent* (New Haven: Yale University Press, 2007), 310.

increased, the smaller countries like the DR, who understood their positions and had economies with strong orientations towards the U.S. market, needed to lock in future opportunities. They simply could not afford to be held back by the interests of the larger South American nations that had more choices. The irony behind the overall breakdown was that MERCOSUR, which had expressed its need for solidarity and consolidations, was also experiencing internal rifts. The fissure became quite apparent when Uruguay announced its intentions to seek a PTA with the U.S.[68]

C. THE CENTRAL AMERICA COMMON MARKET (CACM)

Although the FTAA has made a significant attempt to integrate trade throughout the entire hemisphere, other smaller efforts to form trading blocs have taken place in the 20th century. In Latin America regional integration began with the CACM in 1960 and was followed in the 1960s and 1970s by the Latin American Free Trade Association, the Andean Pact, and CARICOM. What is important to comprehend is that it has only been in the last two decades that the economic and trade agreements have started to function as more effective and operational units. The main driving forces that have allowed the agreements to advance have been the pressures of the World Trade Organization (WTO) and the FTAA. This has certainly been the case for the CACM and CARICOM.[69] During the initial stages of integration, the schemes' primary goal was to increase trade through selective preferences, especially in manufacturing; the organizations sought to enlarge their markets through protective markets and import substitution industrialization (ISI).[70]

In an attempt to emulate the European Economic Community (EEC), the Central American republics set out to form the first customs union in Latin America. The founders of CACM hoped that the customs union would reduce the region's dependence on the external sector, improve the net barter trade, and achieve industrialization.

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[68] Patrice Franko, *The Puzzle of Latin American Economic Development* (Lanham: Rowan & Littlefield Publishers Inc., 2007), 263.

[69] Emilio Pantojas Garcia, "Economic Integration and Caribbean Identity: Convergences and Divergences," *Caribbean Studies* 36, no. 1 (2008): 55.

[70] Michael Reid, *The Forgotten Continent* (New Haven: Yale University Press, 2007), 306.

Through rapid industrialization and the mutual sharing of the net benefits, it was expected that the area would raise incomes and lower reliance on the rest of the world. Industrialization was achieved to large extent by freeing trade in the region and establishing a common external tariff (CET) on third countries. [71]

During the first decade, the CACM experienced substantial growth with its newly established model. People within the member nations and the international community recognized the achievements, which included an impressive eight-fold increase in intraregional trade from 1960-1968. Economic analysis demonstrated overall statistical and dynamic growth for the region, but unequal growth and development patterns started to emerge in certain sectors and in the poorer nations of the bloc.[72] Honduras was particularly strained, as it failed to attract new investments in the manufacturing sector, was forced to pay monetary penalties for compensation, and saw a continual deterioration in the net barter terms of trade. Conditions became so unfavorable for Honduras that it opted to leave the tariff union in 1970, and its departure signaled the beginning of the demise of the original CACM. Unequal growth throughout the region, fiscal revenue losses caused by the duty-free intraregional imports, and easily saturated markets that prevented optimal production levels all combined to undermine the hopes of achieving a common market.[73]

Although during the 1970s interregional and external trade continued to expand, the CACM lost the dynamism that had helped fuel it during the first decade. One significant change was that traditional primary export products overtook the manufacturing sector as the catalyst of growth. Ironically, the latter was what the region was originally trying to move away from. Secondly, the region started to experience significant political changes related to the crumbling of the Somoza government in Nicaragua and the gains made by leftist parties in El Salvador.[74] The final forces that

[71] Victor Bulmer-Thomas, "The Central American Common Market: From Closed to Open Regionalism," *World Development* 26, no. 2 (1998): 314.

[72] J.F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The U.S.-Central America Free Trade Agreement (CAFTA): Challenges for Sub-Regional Integration,* June 1, 2004, 8.

[73] Victor Bulmer-Thomas, "The Central American Common Market: From Closed to Open Regionalism," *World Development* 26, no. 2 (1998): 315.

[74] Ibid, 315.

swelled to break CACM's integration vision were the combination of the drop in value of extraregional exports due to the 1982 Latin American debt crisis, the consequent restructuring and stabilization programs, and the civil wars and unrest that enveloped large portions of the region. By 1986 the combination of effects had also taken its toll on intraregional trade, which had been halved and accounted for only 15% of the total trade.[75] It was clear by the mid 1980s that the initiative had come to an unfortunate halt and would not be reinvigorated until the political and economic landscape had been settled and could provide a new and realistic premise for growth.

The early 1990s ushered in a more stable political and economic era for Central America (CA) as the regional peace process was being implemented and the nations moved away from protectionism and low value added primary goods exports. A new emphasis was placed on trying to unite the region through export led growth in nontraditional products and trade liberalization. The CA nations realized that integration would allow them to exploit economies of scale, and they received important backing from the business sector and civil society.[76] As Rafael Callejas, former president of Honduras stated, "the demands of the competing in the global economy have prompted the Central American countries to abandon the state-dominated, protectionist economic models of the past in favor of free markets, free trade, and open investment."[77] It was this turn towards a different model for economic growth that would help set the foundations for the DR-CAFTA. The drive towards economic integration was codified with the signing of the Protocol of the Tegucigalpa in 1991 that created the Central America Integration System (SICA). The SICA established a new legal and institutional framework for the regional integration process, and helped pave the way for updating the outdated CACM agreement.[78]

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[75] J. F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The U.S.-Central America Free Trade Agreement (CAFTA): Challenges for Sub-Regional Integration,* June 1, 2004, 9.

[76] Patrice Franko, *The Puzzle of Latin American Economic Development* (Lanham: Rowan & Littlefield Publishers Inc., 2007), 260.

[77] Leonardo Callejas, "The Americas: Extend Free-Trade Accords Southwards," *Wall Street Journal*, January 31, 1992.

[78] Victor Bulmer-Thomas, "The Central American Common Market: From Closed to Open Regionalism," *World Development* 26, no. 2 (1998): 316.

Another important aspect of the SICA was that it also looked to expand its membership and association with the other nations of the region. As the Central American nations were looking to integrate themselves into the global community, they reached out to their Caribbean neighbors to seek the establishment of a partnership for prosperity.[79] The inclusion of neighboring nations can be viewed in a grander scheme as a natural extension of the transformation process from inward to outward looking growth. The expansion process was initiated at the III Extraordinary Meeting of Presidents of Central America held in Santo Domingo, DR, in 1997, where Belize, Panama, and the DR signed a Declaration and Framework Cooperation Agreement with the original SICA members. For the DR, which at the time was seeking to cement opportunities in new markets, the stipulations in paragraph eleven were of particular interest because they expressed the intent to establish a FTA between CA and the DR.[80]

The negotiation process of the CA-DR FTA was aimed at liberalizing tariffs on goods, services, and investments to the maximum extent possible, with certain justified exceptions.[81] What was important for all the nations involved, however, was that their leaders recognized that the challenges presented by the new world order could be better faced with a united front. The new challenges required closer ties and cooperation in order to prevent the demands created by globalization from stunting potential growth and to allow the citizenry to achieve acceptable living standards.[82] Individually it would have been impossible for the small nations to maintain the comparative advantages that they had achieved, especially in building increased growth in the U.S. market. The CA-DR FTA was a modern, third generation PTA patterned in the NAFTA fashion that was

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[79] Leonardo Callejas, "The Americas: Extend Free-Trade Accords Southwards," *Wall Street Journal*, January 31, 1992.

[80] Organization of American States, Foreign Trade Information System (SICE), *Trade Policy Developments: Central America-Dominican Republic*, http://www.sice.oas.org/TPD/CACM_DOM/CACM_DOM_e.ASP (accessed June 10, 2009).

[81] Secretariat for the Central American Economic Integration (SIECA), *Press Release on the Signing of the Central American- Dominican Republic Free Trade Agreement Framework*, Santo Domingo, April 16, 1998, http://www.sieca.org.gt/publico/marco_legal/tratados/declaracion_de_prensa_de_los_min.htm (accessed June 10, 2009).

[82] Secretaría de Integración Económica Centroamericana, *Declaracion De Santo Domingo*, Santo Domingo, November 06, 1997. http://www.sice.oas.org/TbePD/CACM_DOM/Negotiations/Declaracion_s.pdf (accessed June 10, 2009).

specifically designed to fit into the mold of the FTAA framework. By creating the FTA, the nations created an open market that could integrate the $50 billion already being generated in the space and unite over 40 million potential consumers.[83]

For both the DR and CACM, this PTA was the first of its kind signed by either party and would set the stage to bring the nations closer to each other during the late 1990s and early 2000s. The negotiations between the CACM nations and the DR also set a precedent for intra-regional trade cooperation in trade negotiation, and would prove to be vital once the nations started to negotiate the DR-CAFTA.[84] It is important to note that although the treaty was negotiated and signed as a whole, each CA nation had its own set of guidelines and obligations to which it had to conform vis-à-vis the DR.[85] The latter arrangement would eventually create greater efficiency when all the nations started to negotiate the DR-CAFTA. Since it would not be necessary for the Caribbean nations to negotiate amongst each other, they would be able to present a united bloc in the negotiation process with the U.S. The CA-DR FTA was signed by all nations on the November 28, 1998, and went into effect after the Dominican Congress approved it and El Salvador ratified it on October 3, 2001.[86]

D. THE CARIBBEAN COMMUNITY (CARICOM)

At the same time that the DR and the CACM were attempting to establish closer ties, the DR also reached out to its other Caribbean neighbors by pursing negotiations with the nations of the CARICOM. The DR had previously expressed interest in opening trade with the CARICOM and was granted observer status in 1982. The DR had also

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[83] Secretariat for the Central American Economic Integration (SIECA), *Press Release on the Signing of the Central American- Dominican Republic Free Trade Agreement Framework*, Santo Domingo, April 16, 1998, http://www.sieca.org.gt/publico/marco_legal/tratados/declaracion_de_prensa_de_los_min.htm (accessed June 10, 2009).

[84] J. F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The U.S.-Central America Free Trade Agreement (CAFTA): Challenges for Sub-Regional Integration,* June 1, 2004, 10.

[85] Organization of American States, Foreign Trade Information System (SICE), *Protocol to the Central American-Dominican Republic Free Trade Agreement,* Miami, November 28, 1998, http://www.sice.oas.org/TPD/CACM_DOM/Negotiations/protocol_s.pdf (accessed June 10, 2009).

[86] Organization of American States, Foreign Trade Information System (SICE), *Trade Policy Developments: Central America-Dominican Republic*, http://www.sice.oas.org/TPD/CACM_DOM/CACM_DOM_e.ASP.

applied for full membership status in 1991, but at the time the CARICOM failed to respond to the official request.[87] In August of 1998, the DR signed an FTA with the CARICOM that would come into force in 2001, but in many ways the road towards achieving this PTA was not as smooth as the CA-DR FTA.[88] The issues behind achieving closer relations and trade between the DR and the CARICOM nations, perhaps, can be found in the nature of CARICOM's organization and history.

The CARICOM was originally established in 1973 as an attempt to achieve economic integration through a customs union and policy and functional cooperation, for the former British territories.[89] The attempt to foster collective economic growth was a new trajectory for the island nations that since colonial times had produced similar commodities and were positioned to compete for the same markets and investments.[90] This fact was initially reflected in CARICOM's initial English-speaking membership, but since then the organization has embraced and included other willing nations of the Caribbean.[91] In the early 1990s, the CARICOM nations committed themselves to deepening regional economic integration by creating the CARICOM Single Market and Economy (CSME). The CSME sought to further enable the established system by providing full factor economic mobility and harmonization in a single space that would encourage regional trade, production, and investment. What had become apparent to the CARICOM at the time was that the international economic environment required that the nations make adjustments and transform themselves to meet the new demands.[92]

Although the nations had multiple reasons that drove them to stronger integration,

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[87] Ronald Sanders, "Dominican Republic in CARICOM? Not Yet " *Caribbean Net News*, August 23, 2005, http://www.caribbeannetnews.com/2005/08/23/sanders.shtml.

[88] Organization of American States, Foreign Trade Information System (SICE), *Trade Policy Developments: CARICOM-Dominican Republic*, http://www.sice.oas.org/TPD/CAR_DOM/CAR_DOM_e.asp (accessed June 10, 2009).

[89] Mauricio Mesquita Moreira and others, "Regional Integration: What is in it for CARICOM?/Comments," *Economía* 8, no. 1 (2007): 97.

[90] Richard Bernal, "CARICOM Single Market and Economy Charts Destiny," *America*, May 1, 2007, 47.

[91] Anthony Payne, "The New Politics of 'Caribbean America,'" *Third World Quarterly* 19, no. 2 (1998): 209.

[92] Richard Bernal, "CARICOM Single Market and Economy Charts Destiny," *America*, May 1, 2007, 48.

the nations' overriding incentive was to reduce some of the disadvantages they faced arising from their individual small sizes. The CARICOM nations wanted to combine the factors they possessed to create economies of scale, which would allow them to increase productivity, diversify output, and spur growth.[93] This, in turn, would allow the trade group to link into the FTAA initiative and the global economic system. This belief was very similar to the motivation behind CACM's desire to establish closer connections, which points to the possibility that smaller nations are willing to sign PTAs with similarly endowed nations to achieve stronger standing when entering a larger market. The CSME has come a long way in the last two decades, but is not fully completed. It is expected that after the full implementation of the CSME, the CARICOM nations will be able to move to the next phase that will extend beyond trade liberation and address common policies and instruments. The CARICOM still faces serious challenges that must be addressed. First, it must address the difference in country sizes, economic structures and policies, rates of growth, levels of development, and institutional capacities. Then it must attend to the need for increased public awareness, especially among the private business sector. Finally it must deal with the need to develop human resources through education and vocational training that establish an internationally competitive labor force.[94]

One of the important things that the CSME established in 1997 was the Caribbean Regional Negotiating Machinery (CRNM), which provided the mechanisms needed to conduct trade negotiations with third countries. In its own attempts to link to the global market, the CARICOM began talks with the European Union (EU) and other nations to negotiate a several PTAs.[95] The DR was one of the nations that was pressing hard to establish a PTA with the CARICOM, even after its initial attempts at full membership were ignored. The DR may have been motivated to seek the CARICOM's markets for various reasons of which subregionalization was certainly a major part. For the DR and the CARICOM, the new PTA was expected to help all member nations prepare their

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[93] Mauricio Mesquita Moreira and others, "Regional Integration: What is in it for CARICOM?/Comments," *Economía* 8, no. 1 (2007): 97.

[94] Richard Bernal, "CARICOM Single Market and Economy Charts Destiny," *America*, May 1, 2007, 51.

[95] Ibid., 49.

small economies for the eventual FTAA. It was an attempt to gradually open up increasingly larger economic spaces and consolidate the resources needed to confront the larger hemispheric market. The PTA was of importance to Dominican leaders because they considered the country to be well suited to act as the logical and natural bridge between the Caribbean and CA nations.[96] To further subregional cooperation in 1997, the DR government took the proactive step of proposing a Strategic Alliance between CA and the Caribbean nations, which was intended to create a free trade area and strengthen the regional space with common positions, objectives, interests, and goals.[97]

The conflictive negotiations surrounding the DR and CARICOM with the European Union (EU) are another reason for the complications behind increasing geopolitics and the need for regional cooperation. Sir Ronald Sanders, a former Caribbean diplomat, claimed that in 1998 the "CARICOM was constrained by external factors to formalize a relation with the DR."[98] The external factors pointed out by Sanders amounted to pressures from the U.S. and EU that indirectly forced the nations into signing a PTA. This position directly undermines any genuine intention by the DR to increase Caribbean integration.[99] Sanders further accused the DR of trying to establish the PTA and later attempting to join the CARICOM in 2005 to negotiate a better position to establish a long term Economic Partnership Agreement (EPA) with the EU.[100]

Clara Quiñones, Ambassador and Advisor to the Minister of Foreign Affairs of the DR, points out that when the DR decided to negotiate with the EU through the Caribbean Forum (CARIFORUM), it did so after numerous consultations with national and CARICOM leaders. The fact that the DR used the CRNM as the negotiation mechanism proved that the DR was looking to establish common positions with the CARICOM

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[96] James Canute, "CARICOM in trade deal with Dominican Republic," *Financial Times,* August 24, 1998.

[97] Clara Quiñones, "Dominican Republic in CARICOM? Yes, we can," *Caribbean Net News*, September 21, 2005, http://www.caribbeannetnews.com/2005/09/21/can.shtml (accessed June 10, 2009).

[98] Ronald Sanders, "Dominican Republic in CARICOM? Not Yet," *Caribbean Net News*, August 23, 2005, http://www.caribbeannetnews.com/2005/08/23/sanders.shtml (accessed June 10, 2009).

[99] Emilio Pantojas Garcia, "Economic Integration and Caribbean Identity: Convergences and Divergences," *Caribbean Studies* 36, no. 1 (2008): 64.

[100] Ronald Sanders, "Dominican Republic in CARICOM? Not Yet," *Caribbean Net News*, August 23, 2005, http://www.caribbeannetnews.com/2005/08/23/sanders.shtml (accessed June 10, 2009).

nations in order to further collective interests. The establishment of the PTA was clearly in line with what the DR was attempting with the CACM, and the proposed Strategic Alliance would only have helped to consolidate the smaller economies of the Caribbean Basin. As for the EPA, the DR could have tried to deal with the EU directly, which was a possibility that was proposed by the EU and the African, Caribbean, and Pacific (ACP) Group.[101]

Through all the controversy the DR and CARICOM were able to come to an agreement and establish an FTA in 1998, although full implementation has been harder to achieve. When the framework of the agreement was established, the Secretariat of CARICOM stated that globalization required fundamental changes in the economies and development process of the Caribbean Region and increased the risk of marginalization for smaller and vulnerable economies.[102] The signing of the CARICOM-DR FTA was a positive step taken to bring the Caribbean nations together. Winston Griffith points out that during the early 1990s the DR had become a global platform that created intense competition for the CARICOM nations. Griffith acknowledged the DR's attractiveness due to its cheap labor and its relatively inexpensive space in the FTZs; this comparative advantage was believed to be the cause of CARICOM's inability to take full advantage of the CBI.[103] With the new CARICOM-DR FTA, it was hoped that animosities and mistrust, which had been building up over the previous decades, could be worked out.

The internal issues that the CARICOM is still trying to resolve have slowed the implementation of both the CARICOM-DR FTA and any further integration efforts. The FTA came into force on December 1, 2001, when Barbados, Jamaica, and Trinidad and Tobago completed the necessary steps to implement the agreement. Since then only three nations, including the DR, have signed the PTA.[104] Sanders concludes that as of 2005

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[101] Clara Quiñones, "Dominican Republic in CARICOM? Yes, We Can," *Caribbean Net News*, September 21, 2005, http://www.caribbeannetnews.com/2005/09/21/can.shtml (accessed June 10, 2009).

[102] Secretariat Caribbean Community, *The Statement of Santo Domingo-The Caribbean Encounter: Towards the 21st Century*, Georgetown, September 4, 1998.

[103] Winston Griffith, "CARICOM Countries and the Caribbean Basin Initiative," *Latin American Perspectives* 17, no.1 (1990): 40.

[104] Organization of American States, Foreign Trade Information System (SICE), *Trade Policy Developments: CARICOM-Dominican Republic*, http://www.sice.oas.org/TPD/CAR_DOM/CAR_DOM_e.asp (accessed June 10, 2009).

CARICOM still needed to consolidate its internal economic arrangements, which would allow them to increase their competitive capacity. Ironically, this was the same argument used by MERCOSUR in its initial references towards the FTAA. The internal "house cleaning" was considered to be of extreme importance to CARICOM, since it was still in the process of establishing the CSME. The addition of any new members, like the DR, was supposed to complicate CARICOM's overall long-term goals. Sanders also expressed his apprehension about opening up CARICOM to the DR's much larger market, which could potentially produce an overwhelming effect on the smaller nations if not done gradually.[105]

In 2008, Federico Cuello Camilo, DR ambassador to the EU, stated the DR was no longer interested in pursuing membership status in light of the DR-CARICOM FTA implementation record. The DR has voiced its concerns over the implementation of any of the CARICOM's PTAs and of the organization's ability to act as the implementing authority for the CARIFORUM/EU EPA. Cuello Camilo told reporters that the DR would prefer to work with the mechanisms that were in place and seek further improvements.[106]

E. THE CARIBBEAN BASIN INITIATIVE (CBI)

The countries of the Caribbean have taken positive steps towards greater integration, and the process has produced significant changes and growth in many of the economic sectors of the individual nations. Although commendable strides have been made to pool common resources in the area, none of the aforementioned PTAs has had the overall impact as the CBI. Through the use of the CBI, the U.S.'s interests have been able to transform the entire nature of the area's economic growth. The CBI, created under the Reagan Administration in 1983, was a unilateral PTA that allowed Caribbean nations to export products to the U.S. whose previous entry had been blocked by

[105] Ronald Sanders, "Dominican Republic in CARICOM? Not Yet," *Caribbean Net News*, August 23, 2005, http://www.caribbeannetnews.com/2005/08/23/sanders.shtml (accessed June 10, 2009).

[106] Anonymous, "Dominican Republic not interested in CARICOM," *Dominican Times*, December 13, 2008, http://www.dominicantoday.com/dr/economy/2008/12/13/30409/Dominican-Republic-not-interested-in-Caricom (accessed June 10, 2009).

tariffs.[107] The program, which was enacted through the Caribbean Basin Economic Recovery Act (CBERA), was a wide-ranging agreement and was intended to address the region's economic woes by introducing free trade, investment incentives, and increased economic aid. At the time the U.S. believed that the area's general economic model needed to shift, especially in light of the negative impacts of the volatility of the world oil market and the declining prices of their traditional major exports such as sugar, coffee, and bauxite. The overall situation was complicated by high rates of unemployment, declining gross national products, balance of payment deficits, and lowered tourism levels.[108]

The nature of the CBI changed the Caribbean's central dynamic of development towards an exogenous source, i.e. the U.S., which had set a priority of creating market-based economies capable of competing with international export markets. Anthony Payne concluded that the economic revolution did not come about without any strings attached. By using the CBI, the U.S. used a policy of "carrot and stick" with the Caribbean nations. The carrot in this case was a nonreciprocal trade and aid program that helped friendly nations, while the sticks were the structural adjustment packages imposed by the IMF and World Bank.[109] It is important to remark that the CBI had a particular security aspect to it, as only nations meeting strict criteria, such as being non-communist and fighting the flow of narcotics, were allowed to become beneficiaries.[110] Thus the U.S. was able to mold the major aspects of the basin's future growth. For many of the countries that were facing major crises, created by the seemingly insurmountable problems, there was little alternative but to accept the new economic incentives.[111]

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[107] Herbert L. Jacobson, "The Americas: False Promises of the Caribbean Basin Initiative," *Wall Street Journal*, April 4, 1986.

[108] William Corbett Jr., "A Wasted Opportunity: Shortcomings of the Caribbean Basin Initiative Approach to Development in the West Indies and Central America," *Law and Policy in International Business* 23, no. 4 (1992): 951.

[109] Anthony Payne, "The New Politics of 'Caribbean America,'" *Third World Quarterly* 19, no. 2 (1998): 210.

[110] William Corbett Jr., "A Wasted Opportunity: Shortcomings of the Caribbean Basin Initiative Approach to Development in the West Indies and Central America," *Law and Policy in International Business* 23, no. 4 (1992): 951.

[111] Anthony Payne, "The New Politics of 'Caribbean America,'" *Third World Quarterly* 19, no. 2 (1998): 210.

Since the CBI's inception, the PTA has seen numerous modifications that have been aimed at fixing some of the barriers preventing the beneficiaries from taking full advantage of the opportunities. In some cases the CBI nations have achieved limited success for reasons attributed to the detrimental internal conditions that exist in the nations themselves. Issues such as a non-dynamic manufacturing class, the unattractiveness of the smaller nations as global platforms, lack of adequate inland transportation, undersized port facilities, and unreliable energy sources are among the many problems that some of the nations needed to address.[112]

Another significant aspect that prevented progress is the difference in expectations between the U.S. and some of the Caribbean nations. Tariffs were removed on many products; however when the CBI came into force, 87% of the basin's products already entered the U.S. duty-free. In effect the CBI only managed to have a positive impact on 7% of the trade at the time, and it excluded the region's most competitive export products, which were sugar, petroleum, and textiles.[113] This was an issue that the Caribbean nations consistently brought up during discussions, but as Alexander Good, the CBI Ombudsman, points out, the CBI was not implemented to promote the major exports of the region. From the U.S. point of view, the Caribbean governments needed to take the adequate measures to provide a local business climate that would attract foreign direct investment (FDI) and look for opportunities in nontraditional exports.[114] The strategy called the nations to take steps to create attractive investment packages, improve telecommunications, build free trade zones (FTZs), and establish industrial parks.[115] Thus, there were necessary pre-conditions to meet for the developing nations to capitalize

[112] Winston Griffith, "CARICOM Countries and the Caribbean Basin Initiative," *Latin American Perspectives* 17, no.1 (1990): 35.

[113] William Corbett Jr., "A Wasted Opportunity: Shortcomings of the Caribbean Basin Initiative Approach to Development in the West Indies and Central America," *Law and Policy in International Business* 23, no. 4 (1992): 951.

[114] Winston Griffith, "CARICOM Countries and the Caribbean Basin Initiative," *Latin American Perspectives* 17, no.1 (1990): 34.

[115] William Corbett Jr., "A Wasted Opportunity: Shortcomings of the Caribbean Basin Initiative Approach to Development in the West Indies and Central America," *Law and Policy in International Business* 23, no. 4 (1992): 951.

on the exportation of non-traditional goods and services. Although some nations in the basin fell behind in creating the proper conditions, one of the countries that quickly stepped up to meet the challenge was the DR.

In creating the proper conditions for the investments, the DR had specific advantages that offered firms the ability to complete globally, especially in the light manufacturing industry. During the late 1980s, there was a significant global trend that began to take place that shifted labor-intensive manufacturing jobs to relatively low wage regions. Griffith observes that Mexico, the DR, and many Asian countries were able to take advantage of the growing labor shift, because they had become wage competitive. In general the nations had become "global platforms," because they offered a mix of inexpensive unskilled and skilled workers from an abundant labor pool.[116] In the DR the majority of the export-processing industries quickly took over much of the operations occurring in the FTZs; this was a remarkable change from the slow start the FTZs had when they were first introduced to the country in 1970.[117] What was certain was that by 1990 the DR had become the world's largest non-Asian supplier of apparel to the U.S. market.[118]

E. CONCLUSION

The attempt made to foster Western Hemisphere regionalization, which started during the 1990s, played a major role in aligning most if not all the Latin American nations towards trade liberalization and open markets. Although currently the FTAA's objectives are further than ever from being reached, it is important to note the significant impact the initiative has had in helping to operationalize and produce smaller coalitions of trading units. This is quite evident by the 43 PTAs that have been signed by Western

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[116] Winston Griffith, "CARICOM Countries and the Caribbean Basin Initiative," *Latin American Perspectives* 17, no.1 (1990): 41.

[117] Gregory, Steven, *The Devil Behind the Mirror* (Berkeley: University of California Press, 2007), 137.

[118] Winston Griffith, "CARICOM Countries and the Caribbean Basin Initiative," *Latin American Perspectives* 17, no.1 (1990): 41.

Hemisphere nations in the period between 1990 and 2005.[119] Within the FTAA initiative it was believed that smaller trading units could be the foundation for the colossal undertaking; this was a common position that was advocated even by the leaders of the conflicting arguments, which were Brazil and the U.S. Trading blocs, such as the CACM and the CARICOM realized that the models on which they had originally been built were no longer sustainable and had to be adjusted to the new global structure. Due to differing interests and the hopes of attaining the maximum amount of leverage during the negotiation process, the entire region had become polarized into two determined and fairly unyielding bands.

For the smaller nations, like the DR that had benefited substantially by adopting the new economic model, it was clear that they had to consistently gauge and adjust to the dynamic global situation to maintain any comparative advantage they had accrued. This translated into opening and maintaining new markets, exporting nontraditional goods and services, and developing PTAs with nations with similar markets sizes and endowments. The fact that the FTAA initiative had broken down did not prevent the smaller nations from seeking out new partnerships with each other or with the U.S. In the Caribbean Basin, the latter was especially true, as nations realized the implications involved after the CBI and trade liberalization had transformed their nations significantly.

The DR was certainly keen to seek new economic opportunities and reached out to its Caribbean neighbors in an effort to integrate itself into larger trading entities. The DR specifically viewed its position, both geographically and economically, as a bridge that could unite the entire Caribbean basin. This was established by the FTAs that were signed by the DR with the CACM and CARICOM. These agreements cemented many new prospects, but one important piece was missing. How would the DR maintain the preferential treatment status of its goods and services for the long term with the U.S., its largest trading partner? It was the answer to this question that would push not only the DR, but also CA, into negotiating a PTA with the U.S. It is important to look specifically at how the DR changed, during the 1970s, from a significantly closed economy

[119] Antoni Estevadeordal and Kati Suominen, "Rules of Origin in Preferential Trading Arrangements: Is All Well With the Spaghetti Bowl in the Americas?" *Economía* 5, no. 2 (2005): 64.

dependant on traditional exports, to a nation looking to establish an enduring and permanent link to the U.S. and the CA nations. This will be the focus of Chapter III.

III. THE TRANSFORMATION OF DOMINICAN ECONOMY

A. INTRODUCTION

The process of Western Hemisphere regionalization certainly played a major role in developing trading blocs like the DR-CAFTA, but to understand the motives behind the DR's willingness to negotiate a PTA, it is just as important to look at the economic trajectory the nation took to get to that point. For any nation to negotiate and attain certain terms that will benefit its citizenry in the overall balance of gains and concessions, the nation has to have taken steps to put itself in a position where it could leverage its strong points. In the case of the DR, the building of the foundation needed to take advantage of any PTA, especially with an economic power like the U.S., can be traced to the economic shift that started to transform the nation in the mid-1980s. As with many countries in Latin America and the Caribbean, the 1980s were years of economic turmoil that forced national leaders to implement policies that were austere and pulled back on government intervention as a tool to solving problems.[120] The DR was not exempt from the central economic restructuring trend that smacked the region in the face. What becomes evident in close analysis is that the choices the DR made while opening up its market and the economic sectors that were targeted and promoted for growth played a key role in how the nation would plug into the global economy during the 1990s and 2000s.

The first section of Chapter III will cover the transition that the DR's economy made starting in the mid-1980s, with the economic policies the government took to meet the conditions needed for to receive external financial assistance from the International Monetary Fund (IMF). The austere but necessary economic reforms were a result of poor decisions made by previous governments. The latter half of the 1980s was a period when politicians made attempts to return the country back to the status quo of the 1970s, but the external pressures that forced the country towards reform would not allow the same

[120] Laura Jaramillo and Cemile Sancak, "Growth in the Dominican Republic and Haiti: Why the Grass Been Greener on One Side of Hispaniola" (working paper, Western Hemisphere Department, International Monetary Fund, March 2007), 20, http://www.imf.org/external/pubs/ft/wp/2007/wp0763.pdf (accessed June 10, 2009).

conditions to flourish. It was also during this period that the nation started to take advantage of the benefits of the CBI, whose provisions came in direct conflict with President Joaquin Balaguer's attempt to reinstall "big government" practices.

As in many cases, domestic politics played a major part in the economic practices that were put in place, and in the 1990s the same politicians who longed for the bygone days of statism saw the advantages of adopting the neoliberal policies.[121] The Dominican government introduced a comprehensive economic plan known as the New Economic Program, which implemented significant reforms, but allowed several important distortions and policy weaknesses to undermine full progress. While the DR started to experience sustained growth, it also experienced pressure from regional competition. The implications of NAFTA created great concern among the CBI nations. They saw some of their benefits erode as the Mexican economy became inextricably linked to the rest of North America. The CBI nations knew they would face a series of challenges that included potential trade and investment diversion and the erosion of their margin of preference enjoyed under the CBI provisions. The CBI nations sought to either join NAFTA or at the least establish "NAFTA parity". In the end due to multiple factors, the nations took on the defensive strategy of reforming the CBI and minimizing trade and investment diversion.[122]

The DR continued on its path of economic liberalization and diversification during the latter half of the 1990s, but just as it experienced even greater growth it started to feel the weight of increased global pressures. During this period the DR's economic success was aided by political change and several market friendly economic reforms. The pressure for the DR came from the fact that both tourism and the export processing zones depended heavily upon the health of the global economy. During the late 1990s

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[121] Statism as defined by Javier Corrales refers to tendency of states to intervene in the economy. This can occur through the following: (1) direct ownership of firms; (2) regulation of prices; (3) creation of barriers to entry in different markets; (4) external tariffs on imports; (5) subsidizes for certain sectors; spending beyond revenues; (6) excessive taxes on profit making sectors; (7) using the state as an employer or bank; and (8) creating limits in number of and participants in private transactions.

Jorge Dominguez and Michael Shifter, eds., *Constructing Democratic Governance in Latin America*, 2nd ed. (Baltimore, MD: John Hopkins Press, 2003), 75-76.

[122] Victor Bulmer-Thomas, "The Central American Common Market: From Closed to Open Regionalism," *World Development* 26, no. 2 (1998): 319.

and early 2000s, the country started having problems competing with exports originating in Asia and Central America (CA), as the global light manufacturing sector expanded significantly.[123] This coincided with the DR's attempts to reach out to its Caribbean neighbors in an attempt to form collaborative defense mechanisms against the Asian exports. Many of the Caribbean nations saw the early 2000s as the correct juncture in time to seek a bilateral PTA with the U.S., especially since a good portion of their trade was directed to and coming from that nation. For the U.S., the timing was opportune because the U.S. understood that it had to maintain its strategic partnerships with the Caribbean nations in order to stave of the losses it was suffering from foreign competition.[124]

Unfortunately, as the DR was reaching out to establish strategic alliances and adjusting to the global conditions, it suffered one of the greatest economic collapses of its history. The economic crisis was caused by the government's decision to bailout the country's third largest bank. The *Banco Intercontinental* (*Baninter*) scandal caused significant strain on the country's public finances, but it also forced the government to set stronger regulatory policies that were long overdue. The quick recovery from the economic collapse and the positive steps taken to solve some of the systemic problems opened the door for trade negotiations with the U.S. The DR's original strategy in 2003 was to attempt to pursue a bilateral FTA with the U.S. After careful deliberations the DR and the U.S. both agreed that each sides' interest would be better served if the DR's initiative was docked to the ongoing CAFTA negotiations. Thus the DR's economic transformation followed a path that pushed it to cement its gained benefits and relationships in the light of a dynamic and ever encroaching global environment.

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[123] Claire M. Ribando, U.S. Foreign Affairs, Defense, and Trade Division, Congressional Research Service, *Dominican Republic: Political and Economic Conditions and Relations with the United States*, April 17, 2007, 4.

[124] J.F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The Dominican Republic-Central America-U.S. Free Trade Agreement (DR-CAFTA),* January 3, 2005, 5.

B. THE 1980S: FAILED ECONOMIC POLICY AND RESTRUCTURING

For the DR, the 1980s were a decade marked by major economic upheavals and shifts that forced the leaders of the country to take a very different approach towards economic management practices. Between 1969 and 1973, the DR had one of the highest economic growth rates in the world, at an average of 11%, due to high sugar and primary commodity prices and a significant boom in increased gold exports.[125] As the decade winded down, the DR's terms of trade dropped off sharply as sugar prices fluctuated and oil prices increased significantly. To compound the situation, the government allowed growing balance of payment shortfalls, decreasing revenues from extensive tax exemptions, and mounting expenditures on state operated companies to increase the national debt.[126] As with many countries in Latin America, the problems were temporarily diverted by the governments' abilities to refinance their loans, but the 1980s would bring a set of conditions that would change the economic landscape.

The DR ushered in the 1980s with a new political party at the helm that proposed certain changes, yet the economic distortions that originated during Joaquin Balaguer's presidency (1966-1978) were becoming evident. Many of the government's continued malpractices, such as the administration of large public enterprises that included industrial, commercial, agricultural, and live stock holdings, the subsidization of import-substitution industries (ISI), and the use of fixed exchange rates that greatly overvalued the Dominican peso (DOP), placed significant burdens on the economy.[127] Many of these practices were caused by legacy systems left in place dating back to the Rafael L. Trujillo Era. These legacy systems distorted credit markets, limited development, generated an inefficient industrial base, and ignored other vital sectors such as education

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[125] John T. Cuddington and Carlos Asilis, "Fiscal Policy, the Current Account and the External Debt Problem in the Dominican Republic," *Journal Latin American Studies* 22, no. 2 (1990): 333.

[126] Federal Research Division, Library of Congress, *Country Studies: Dominican Republic,* *http://lcweb2.loc.gov/frd/cs/dotoc.html* (accessed June 8, 2009).

[127] Frank Moya Pons, *The Dominican Republic: A Natural History* (New Rochelle: Hispaniola Books, 1995), 407.

and health.[128] Many destructive and often hidden economic maladies had been left to run their course without an in depth understanding of the changes needed to adjust to the shifting global conditions.

The DR's economic crisis reached a climax when the U.S. decided to reduce Dominican sugar exports by 70% between 1981 and 1987. The crisis was further exacerbated by the Latin American banking crisis, caused by Mexico's moratorium over its foreign debt. The latter shook the confidence levels of foreign lenders, who had been happy to lend money to previous Dominican administrations. As newly elected President Jorge Blanco stepped in office, he was forced to negotiate with the IMF as a necessary condition to receive renewed loans from foreign banks.[129] The situation deteriorated to such a point that it was necessary for the government to sign a three-year extended facilities agreement whose conditions included lower fiscal deficits, tighter credit policies, and other austere economic measures. The new policy, signed in January of 1983, allowed the government to renegotiate the terms and maturities of many short and medium term loans, but the agreement's conditions also sparked massive riots caused by the devaluation of the DOP and increased food prices. After extended political maneuvering and tensions between the administration and the opposing Congress over the IMF conditions, the DR signed a one-year IMF Standby Agreement that included more austerity measures and the floating of the DOP. The latter measures started the DR down the path needed to ensure macroeconomic stability, but the reforms and various miscalculations by the Blanco Administration took its toll on the ruling party, which found itself out of the governance after its four-year stint.[130]

When President Balaguer returned to power in 1986, he completely turned his back on all the necessary reforms that Blanco Administration had put in place. Although Balaguer had campaigned on the platform of privatizing and reorganizing the economy, what he promised and what he delivered were completely opposite. By conjuring up the

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[128] John T. Cuddington and Carlos Asilis, "Fiscal Policy, the Current Account and the External Debt Problem in the Dominican Republic," *Journal Latin American Studies* 22, no. 2 (1990): 332.

[129] Frank Moya Pons, *The Dominican Republic: A Natural History* (New Rochelle: Hispaniola Books, 1995), 414.

[130] Federal Research Division, Library of Congress, *Country Studies: Dominican Republic,* http://lcweb2.loc.gov/frd/cs/dotoc.html (accessed June 8, 2009).

memory of the economic boom of the early 1970s and using the logic of the neo-Keynesian model and aggregate demand, he expanded the role of the government in the economy. His policies initially electrified the economy and led to a 10% GDP growth in 1987, which caused the expansion of the internal market, but the policy of expanding the money supply almost three fold produced tremendous inflation and devaluation.[131] Ironically, the same distortions and problems that had been in place during his previous administration did not provide the lessons needed during the new era. In 1988, the DR economy contracted sharply due to the excessive government spending patterns. Balaguer tried to keep the country's new and rapidly increasing export sector and tourist trade as competitive as possible by continuously devaluating the DOP, but this in turn substantially eroded the quality of life for many poor Dominicans earning fixed salaries. At the end of the decade, the country's foreign debt had reached nearly US$4 billion, roughly double the 1980 figure.[132] It was evident at the end of the decade that the DR's economy was once again on the ropes desperately fighting in a loosing battle.

The Dominican economy during the 1980s could be described as having increased debt, persistent levels of deficits in the balance of payments, failed attempts at restructuring, and spiraling levels of high inflation. Although these factors are all consistent with what many economists call the lost decade in Latin America, they overshadow some of the important positive advances the DR made towards diversifying its economy. The global recession of the early 1980s severely reduced demand for the country's and the basin's primary exports such as bauxite, sugar, and coffee. The economic contraction forced many of the Caribbean nations to look at different alternatives to make their economies grow.[133] At the same time that the DR had reached the apex of its economic crisis, many of the other nations in the Caribbean Basin were also suffering through their own economic debacles; as mentioned in Chapter II, this was something the U.S. noticed. As the DR acquiesced to the IMF's demands, the CBI was

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131 Frank Moya Pons, *The Dominican Republic: A Natural History* (New Rochelle: Hispaniola Books, 1995), 427-429.

132 Federal Research Division, Library of Congress, *Country Studies: Dominican Republic,* *http://lcweb2.loc.gov/frd/cs/dotoc.html* (accessed June 8, 2009).

133 Anthony Payne, "The New Politics of 'Caribbean America,'" *Third World Quarterly* 19, no. 2 (1998): 210.

also enacted in an attempt to help revitalize the basin's economies. The DR took great strides to rapidly diversify away from its primary dependence on sugar and its other primary exports and enacted the Free Trade Zone (FTZ) Law 145 of 1983 to fully take advantage of the CBI.[134] The law offered lucrative incentives for free zone investments that included exemptions from import duties, income taxes, and other taxes for up to twenty years.

Many of the new jobs created in the FTZs were in light manufacturing, particularly the assembly sector, and the FTZ boom that followed the new law helped to offset many of the jobs that were lost, especially in the sugarcane fields. The first FTZ in the DR was opened in 1970, with the objective of generating foreign exchange and jobs, but the sector had not progressed as quickly as originally expected.[135] The 1980s saw a complete turn around in the DR's light manufacturing operations as jobs soared from 16,000 in 1980 to nearly 100,000 by 1989, which represented the world's fastest growth in FTZ employment during the period. Of significant note is that 1987 marked a pivotal crossover point where the value of assembly exports surpassed that of traditional agricultural exports, marking a significant change in the Dominican economic structure (table 1).[136] Thus the DR had started to become a global platform that was able to quickly shift rural workers from agriculture to FTZ employment. The DR also profited tremendously from the increase in tourism during the same period, as it became the Caribbean's fastest growing tourist destination. The growth of the tourism sector started in the 1970s when the Tourist Incentive Law of 1973 designated four specific areas as "*Polos Turísticos*" or touristic poles and provided the needed incentives and mechanisms to spur development.[137] By 1984, tourism surpassed sugar as the nation's leading foreign

[134] Laura Jaramillo and Cemile Sancak, "Growth in the Dominican Republic and Haiti: Why the Grass Been Greener on One Side of Hispaniola" (working paper, Western Hemisphere Department, International Monetary Fund, March 2007), 20, http://www.imf.org/external/pubs/ft/wp/2007/wp0763.pdf (accessed June 10, 2009).

[135] Gregory, Steven, *The Devil Behind the Mirror* (Berkeley: University of California Press, 2007), 137.

[136] Federal Research Division, Library of Congress, *Country Studies: Dominican Republic, http://lcweb2.loc.gov/frd/cs/dotoc.html* (accessed June 8, 2009).

[137] Gregory, Steven, *The Devil Behind the Mirror* (Berkeley: University of California Press, 2007), 210.

exchange earner, marking the DR's efforts to diversify its economy. Along with the latter efforts, the agricultural sector looked towards taking advantage of the CBI by placing new emphasis on the export of nontraditional items such as tropical fruits, citrus, and ornamental plants to the U.S.[138] The exportation of nontraditional exports was the bedrock of the CBI, and the DR made the necessary adjustments to exploit the new possibilities. Although the DR faced significant issues caused by debt, restructuring, and mismanagement, the country had definitely set down a particular trajectory and laid the foundations needed to tie it to the global market that expanded significantly during the 1990s.

Table 1. Dominican Republic: Value of Exports, 1982-87
(In millions of United States dollars[1])

Kind of Export	**1982**	**1983**	**1984**	**1985**	**1986**	**1987**
Traditional[2]	475	452	514	380	360	308
Free-zone	148	175	194	205	250	323
Other	294	336	358	365	363	410
TOTAL	917	963	1,066	950	973	1,041

[1] Free on board. □[2] Sugar and derivatives, green coffee, tobacco, and cocoa.
(From: Library of Congress, 1989)

C. TRADE LIBERALIZATION, GROWTH & THE PRESSURES OF GLOBALIZATION

For the DR, the 1990s marked a period of significant economic growth coupled with the building of stronger democratic institutions. Reforms in both the government and the economic sector were instrumental in paving the way for increased national development. These two factors fed off of each other to produce an environment that was able to take advantage of the available global opportunities. The rapid expansion of tourism and the FTZ sectors started in the previous decade continued on its accelerated pace, but it also faced significant challenges.[139] The decade can be broken up into two

[138] Federal Research Division, Library of Congress, *Country Studies: Dominican Republic,* http://lcweb2.loc.gov/frd/cs/dotoc.html (accessed June 8, 2009).

[139] Claire M. Ribando, U.S. Foreign Affairs, Defense, and Trade Division, Congressional Research Service, *Dominican Republic: Political and Economic Conditions and Relations with the United States*, April 17, 2007, 4.

periods based on the pace of changes that occurred, starting with the initial phase of the reform effort from 1991 through 1995. It was during this period that the New Economic Program was established by the Balaguer Administration.[140] The second phase was the new governmental period from 1996 through 1999, which was a direct consequence of the "Pact for Democracy", signed in 1994. This significant milestone in Dominican politics opened the way for free and fair elections by removing Balaguer from the presidential contention and bringing to power new leadership that was focused on furthering neoliberal reforms.[141]

Unfortunately, the beginning of the decade greeted the DR with avoidable political and economic disorder. During 1990, Balaguer's Administration continued to loosen its financial policies prior to the presidential election, which resulted in inflation rising to 100%, a frantic flight of capital and foreign exchange, and the lack of basic living amenities. According to Moya Pons, "never since the end of the Trujillo dictatorship, had the DR experienced such a dismal economic and spiritual state."[142] Ironically, through what many considered fraudulent elections, Balaguer was able to maneuver through the deficient electoral process and remain in power. Although the country was paralyzed by shortages of fuel, electricity, running water, and basic foodstuffs, the elected government failed to pay its debts to its creditors, and the crisis continued to spin out of control. It as only after the realization of a failed economy and intense international pressure from the IMF, World Bank, and the Inter-American Development Bank (IDB) that Balaguer promised to undertake fundamental reforms to ease the crisis.[143]

The initial phase of the reform thrust during the first part of the decade was codified through the New Economic Program. The comprehensive program included

[140] P. Young and others, International Monetary Fund, "Dominican Republic: Selected Issues," October 1999, 11, http://www.imf.org/external/pubs/ft/scr/1999/cr99117.pdf (accessed June 10, 2009).

[141] Claire M. Ribando, U.S. Foreign Affairs, Defense, and Trade Division, Congressional Research Service, *Dominican Republic: Political and Economic Conditions and Relations with the United States*, April 17, 2007, 2.

[142] Frank Moya Pons, *The Dominican Republic: A Natural History* (New Rochelle: Hispaniola Books, 1995), 443.

[143] Ibid.

fiscal consolidation and the liberalization of exchange rates, prices, and interest rates.[144] The nation also made serious attempts to normalize relations with external creditors with the help of an IMF Standby Arrangement in 1991, which was extended in 1993. Fiscal consolidation was the main driver of the New Economic Program, and in 1990 the prices of many public goods and services were deregulated to reflect opportunity costs, while food subsidies were removed. With the new changes the government was able to shift the public sector balance from a deficit of approximately 1% in 1990 to a surplus that averaged 2.8% for the next four years.[145] Along with these changes there were a series of steps taken to revamp several outdated tax laws, strengthen the banking system, tighten monetary policy, and enhance the outward orientation of the Dominican economy. The shift in the orientation of the economy was of extreme importance in linking the DR with global markets, and was complemented with the Foreign Investment Law of 1995, which gave increased guarantees to foreign investors.[146] The new law paved the way for a new and robust source of capital for the developing nation.

The steps taken by the government to implement the reform and stabilization program had definitive positive results. After the disastrous start to the decade, economic growth resumed and was led by those sectors that were more open to competition, such as light manufacturing, tourism, telecommunications, and construction. During the 1991-1995 period, the economy was able to grow at a modest average of over 4%, and inflation was drastically reduced to an average just under 8% (figure 1). With external imbalances being generally contained and other macroeconomic indicators indicating a reliable environment for investment, the DR started to attract a considerable amount of FDI,

[144] Laura Jaramillo and Cemile Sancak, "Growth in the Dominican Republic and Haiti: Why the Grass Been Greener on One Side of Hispaniola" (working paper, Western Hemisphere Department, International Monetary Fund, March 2007), 20, http://www.imf.org/external/pubs/ft/wp/2007/wp0763.pdf (accessed June 10, 2009).

[145] P. Young and others, International Monetary Fund, "Dominican Republic: Selected Issues," October 1999, 11, http://www.imf.org/external/pubs/ft/scr/1999/cr99117.pdf (accessed June 10, 2009).

[146] Laura Jaramillo and Cemile Sancak, "Growth in the Dominican Republic and Haiti: Why the Grass Been Greener on One Side of Hispaniola" (working paper, Western Hemisphere Department, International Monetary Fund, March 2007), 20, http://www.imf.org/external/pubs/ft/wp/2007/wp0763.pdf (accessed June 10, 2009).

which became a steady source of financing for current account deficits.[147] At the same time that it was beginning to take significant steps to link up to the global market, the DR and the entire region started to feel the pressures of open competition. The first wind of concern came when the EAI was proposed by the Bush Administration. Although the EAI was greeted by many as a plan to open up trade throughout the entire hemisphere, some leaders of the Caribbean nations were concerned about the potential erosion of preferential treatment that was attained through the CBI. Many believed that their nations were already at a disadvantage in trade with the U.S. despite the great amount of duty free access many of their products received.[148] Although the initial concerns were based upon the potential of the establishment of the EAI, the erosion of terms became a reality when the NAFTA negotiations started to take shape.

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147 P. Young and others, International Monetary Fund, "Dominican Republic: Selected Issues," October 1999, 13, http://www.imf.org/external/pubs/ft/scr/1999/cr99117.pdf (accessed June 10, 2009).

148 William Corbett Jr., "A Wasted Opportunity: Shortcomings of the Caribbean Basin Initiative Approach to Development in the West Indies and Central America," *Law and Policy in International Business* 23, no. 4 (1992): 951.

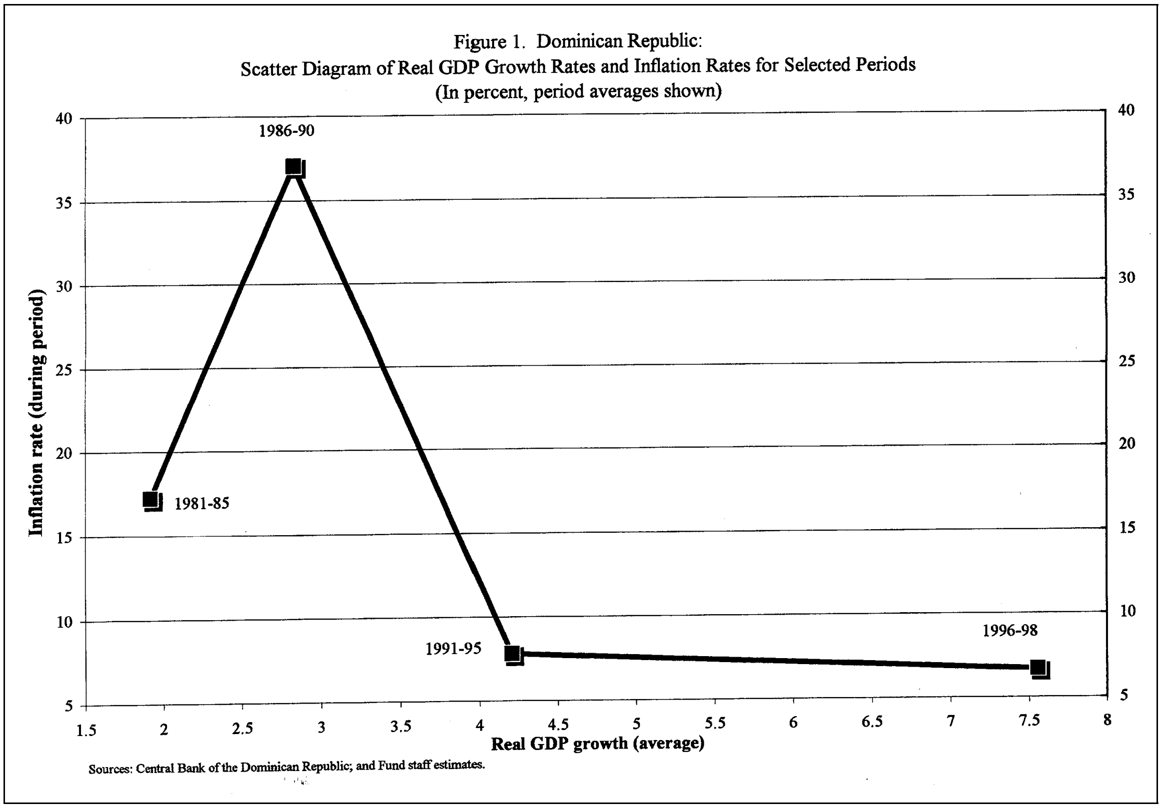

Figure 1. Real GDP Growth & Inflation Rates (1981-1998) (From: Young, 1999)

The NAFTA presented all the CBI nations with three major challenges, which were possible trade diversion, investment diversion, and the demotion of status in the U.S.'s pyramid of hierarchy for export products entering the nation. The inclusion of Mexico in the NAFTA effectively eroded and undermined the margin of preference enjoyed by the DR and CA under CBI. Under the NAFTA many firms, especially U.S. companies, had the ability to move their enterprises to Mexico and take advantage of duty free status and the larger and inexpensive labor pool.[149] In the first two years following the establishment of the NAFTA, DR apparel export growth fell to only 12% in contrast to the 29% that was reported from 1992 through 1994. Conversely Mexican apparel exports grew 123% during the same period, up from the 70% growth they

[149] Victor Bulmer-Thomas, "The Central American Common Market: From Closed to Open Regionalism," *World Development* 26, no. 2 (1998): 316.

experienced before the NAFTA went into effect.[150] The FTAA initiative, which was more concrete than the EAI, further complicated potential trade relationships as CBI nations started to evaluate the possibilities of establishing bilateral FTAs with the NAFTA as an entity and with each member nation individually.[151]

Initially many of the small Caribbean nations hoped there would be a possibility of attaining membership in the NAFTA, but two major factors took that likelihood away. The first was the fallout of the Mexican peso (MXP) devaluation in 1994 that sparked popular outcry in the U.S. against the entire NAFTA design. The second was that the small nations were in no way close to meeting the rigorous conditions imposed by the NAFTA concept. Even nations like Chile, a model of neoliberal success in Latin America, didn't meet the rigorous requirements, thus the smaller economies had to find new ways to cope with the changing trade environment.[152] In essence, nations like the DR had to make quick adjustments in order to keep their economies growing. The DR and Jamaica, which had done the most to take advantage of the CBI opportunities, led a new strategy and tried to press the U.S. to provide "NAFTA parity" to minimize the negative effects that were being experienced.[153] These attempts were met with resistance from U.S. textile and other producers at the time, but global conditions later in the decade caused direct pressure on the U.S. apparel and textile industries and forced them to reconsider their partnerships.

The DR was able to increase its growth rate to 6%-8% during the second half of the decade. This growth was the result of a new government that was committed to advancing reforms that had been built on a solid economic foundation.[154] The growth helped place the DR among the fastest growing economies in the world during that

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[150] Emilio Pantojas Garcia, "Economic Integration and Caribbean Identity: Convergences and Divergences," *Caribbean Studies* 36, no. 1 (2008): 64.

[151] Victor Bulmer-Thomas, "The Central American Common Market: From Closed to Open Regionalism," *World Development* 26, no. 2 (1998): 316.

[152] Ibid.

[153] Anthony Payne, "The New Politics of 'Caribbean America,'" *Third World Quarterly* 19, no. 2 (1998): 210.

[154] Claire M. Ribando, U.S. Foreign Affairs, Defense, and Trade Division, Congressional Research Service, *Dominican Republic: Political and Economic Conditions and Relations with the United States*, April 17, 2007, 4.

period. Although President Leonel Fernández Administration's new agenda faced significant opposition in the Congress, their solution to combating poverty was based on the prerequisite of continued economic growth. There was one thing that was certain, and it was that the opposition could not deny some of the positive results of market liberalization. The keystone of the Fernández Administration was based on trade liberalization, privatization, and public sector modernization, which included increasing the quality of social services. Economic expansion was facilitated by several key economic reforms and the increased influx of FDI (figure 2). One of the major reforms taken was the Public Enterprise Reform Law of 1997 that allowed increased private sector representation in certain productive sectors such as electricity and sugar. It was the government's insistence on maintaining fiscal and monetary discipline that helped to underpin the success, and in looking at past Dominican history, this was a major step towards maintaining sustained progress. [155]

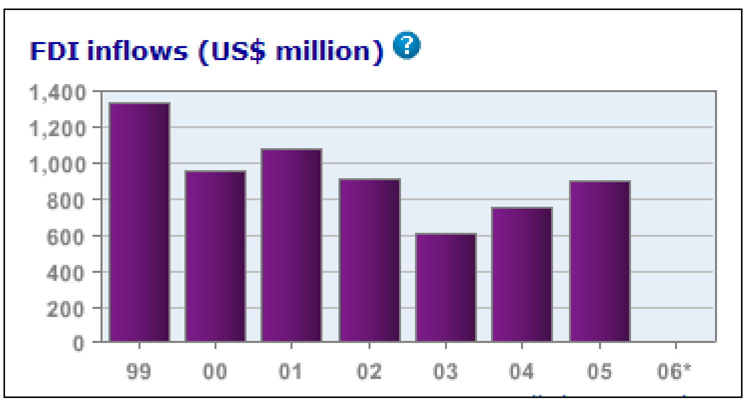

Figure 2. Foreign Direct Investment (FDI) Inflows
(From: Inter-American Development Bank, 2007)

It is not a coincidence that during this period the DR tried to reach out to its Caribbean neighbors in CACM and CARICOM in order to cement new alliances and open new markets and opportunities. Although the DR was looking for new opportunities through the process of subregionalization, what became apparent during this time was that global competition started to take an increased toll on the nation's

[155] P. Young and others, International Monetary Fund, "Dominican Republic: Selected Issues," October 1999, 14-15, http://www.imf.org/external/pubs/ft/scr/1999/cr99117.pdf (accessed June 10, 2009).

thriving sectors. Tourism and the export processing zones were the key elements in transforming the economy, but at the same time both of these sectors were extremely connected to the state of the global economy. The threat of marginalization under the neoliberal construct was a reality that was always on the horizon, and it needed to be dealt with continuously on a real time basis. As the end of the century approached, many Dominican FTZs were facing fierce competition from cheaper goods originating in China, Asia, and CA, and this caused national leaders to look for new ways to adjust to the dynamic conditions.[156] In the latter half of the 1990s as other nations in the Caribbean region were experiencing similar circumstances, they collectively tried to negotiate with the U.S. through of the CBI structure. The CBI nations started to press the U.S. for an increase in the range of products that were available for duty free status during the 1997 Caribbean Summit Meeting held in Bridgetown, Barbados.[157]

The realization of what the U.S. considered "Caribbean trade enhancement" occurred for the CBI nations in 2000 with the passing of the Caribbean Basin Trade and Partnership Act (CBTPA). It was expected that by moving certain portions of the manufacturing production chain to CBI nations, U.S. companies would be able to take advantage of lower manufacturing costs, reduced shipping times, better customer service, reduced overhead costs, and fewer markdowns. The CBTPA was specifically structured to provide the opportunities needed to establish new supply chain partnerships to redirect light manufacturing from the Far East to the Western Hemisphere. This strategy created a mutually beneficial relationship for all partners since the CBI nations would be using mostly U.S. textiles as inputs. [158] It was under this new partnership that the strategic question of how the textile and apparel industries of the U.S. and the Caribbean nations would handle the emerging economic pressure from China and Asia would be framed.

While the U.S. extended more privileges to the CBI nations, the enhancement was also a direct response to support the U.S.'s competition with similar production sharing

[156] Claire M. Ribando, U.S. Foreign Affairs, Defense, and Trade Division, Congressional Research Service, *Dominican Republic: Political and Economic Conditions and Relations with the United States*, April 17, 2007, 4.

[157] Anthony Payne, "The New Politics of 'Caribbean America,'" *Third World Quarterly* 19, no. 2 (1998): 215.

[158] Carlos Moore, "CBI offers 'Targets of Opportunity,'" *Bobbin* 42, no. 3 (2000): 70.

ventures in Asia that were seriously challenging U.S. production and employment in the textile and apparel industries. In the period from 1997 to 2002 the eventual DR-CAFTA nations experienced a decline in the U.S. apparel market share from 11. 7% to 9.4 %. At the same time China's shares increased from 9.1% to 13.0 %.[159] It was estimated by the U.S. International Trade Commission (USTIC) that foreign competition had caused the U.S. to lose 542,000 jobs from 1998-2002, which represented a loss of 38% in the textile and apparel industries. Pressure increased on these industries in the early half of the current decade as the U.S., Canada, and the EU were transitioning towards the elimination of quotas for all World Trade Organization (WTO) nations. This transition was required under the Uruguay Round Agreement on Textiles and Clothing, and its final implementation came into effect on January 1, 2005. The deadline resulted in the liberalization of the framework for world trade in textiles and apparel. At the same time the large amount of suppliers in the market, rising import penetration, and the changing of consumer tastes contributed to the downward pressure on prices of apparel and textiles.[160] As the U.S. textile and apparel industries faced shrinking domestic markets, the thought of sourcing highly labor intensive apparel production to low cost foreign producers in the Caribbean became part of an extensive consolidation and restructuring process.[161] The expiration of quotas would have an immediate impact on the DR's garment industry as it lost approximately 40,000 jobs in that sector in the first two years after its implementation.[162] The new strategy created a potential win-win situation at the time, since 56% of apparel and textile imports from the Caribbean were assembled from

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[159] J.F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The Dominican Republic-Central America-U.S. Free Trade Agreement (DR-CAFTA),* January 3, 2005, 5.

[160] Soamiely Andriamananjar and Marinos Tsigas, U.S. International Trade Commission, *The Economic Effects of Significant U.S. Imports Restraints*, Publication 3701, (Washington, DC, June 2004), 59. http://www.usitc.gov/publications/pub3701.pdf (accessed June 10, 2009).

[161] Ibid., 60.

[162] Claire M. Ribando, U.S. Foreign Affairs, Defense, and Trade Division, Congressional Research Service, *Dominican Republic: Political and Economic Conditions and Relations with the United States*, April 17, 2007, 4.

U.S. material as opposed to the 1% from China. The strategic partnership was also expected to decrease the rate of job losses in both in the U.S. and the DR.[163]

In the backdrop of all the trade and liberalization changes that were occurring at the turn of the century, it is important to emphasize that although the FTAA initiative started to stall, the U.S. maintained its position of entering into bilateral PTA negotiations with willing nations. On the sidelines of the IX meeting of the FTAA Trade Negotiation Commission in September 2001, the five members of the CACM met with the U.S. to talk about the deepening bilateral trade and investment relations. The DR would also make its case for establishing a permanent PTA with the U.S. in the summer of 2003.[164] From the perspective of these nations, the goal was to reduce any remaining barriers to the U.S. market not covered by the CBI and to increase flows of FDI. Although the CBTPA had increased trade opportunities, under the stressed economic climate that existed the nations wanted to make the benefits enjoyed under the CBI permanent and further develop the apparel assembly or *maquiladora* industry.[165] Unfortunately just as the DR started to negotiate the FTA conditions with the U.S., it faced a major banking crisis that caused ripple effects throughout its entire economy. The effects of the scandal forced the DR to undertake major reforms in order to take advantage of any opportunity that came out of a potential U.S.-DR FTA.

D. THE ECONOMIC CRISIS OF 2003-2004 & IMPLICATIONS FOR DR-CAFTA

By the beginning of the 21st century, the DR had been effectively transformed into a service oriented economy that relied on tourism, business, and the apparel industry. However, the growth experienced during the 1990s didn't prevent a different political party, the Dominican Revolutionary Party (PRD), from taking the reigns in 2000. In part, the change in government was due to the provision in the DR Constitution that prevented

[163] J.F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The Dominican Republic-Central America-U.S. Free Trade Agreement (DR-CAFTA),* January 3, 2005, 5.

[164] Organization of American States, Foreign Trade Information System (SICE), *Trade Policy Developments: Central America-Dominican Republic-United States,* http://www.sice.oas.org/TPD/USA_CAFTA/USA_CAFTA_e.ASP (accessed June 10, 2009).

[165] J. F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The U.S.-Central America Free Trade Agreement (CAFTA): Challenges for Sub-Regional Integration,* June 1, 2004, 7.

the incumbent president from running for a consecutive term. Under President Hipólito Mejía, the government faced significant challenges providing social services for the poor, increasing education, and aiding the small and middle sized business and agricultural sectors that were hurt by the privatization of government owned enterprises and trade liberalization.[166] It was certain that although the nation had experienced impressive economic growth, there were still many reforms, such as further financial sector deepening, the regulation of banking practices, and the enhancement of competition in markets and services that needed to be institutionalized to maintain growth.[167] The Mejía Administration needed to address some of the latter issues directly when it came into office, but the PRD led government, which had traditionally run on a center-left social democratic platform, would face a its largest challenge when it had to deal with collapse and scandal involving the *Banco Intercontinental* (*Baninter*).

The economic crisis that brought the DR's economy to its knees was directly related to the lack of institutionalized reform desperately needed in the financial sector. In 2003, *Baninter* was the DR's third largest bank, but a lack of regulatory policy and corrupt bookkeeping practices were uncovered that year. This revealed that the bank had extended unregulated $50,000 lines of credit to numerous government officials.[168] Many of the officials abused the lines of credit and didn't repay their loans, which ironically caused the government to step in and launch a widespread investigation. The investigation, which discovered further embezzlement and fraud, consequently caused *Baninter's* customers to lose complete confidence in the bank and to demand their deposits. The rush to retrieve deposits caused the bank to collapse. Subsequently, two other banks decided to close their businesses after the Central Bank mandated all banks in the nation maintain a 10%-15% higher reserve on any money that was not earning

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[166] David Gonzalez, "Dominican Wins Presidency As Opponent Shuns Runoff," *New York Times*, May 19, 2000. http://www.nytimes.com/2000/05/19/world/dominican-wins-presidency-as-opponent-shuns-runoff.html (accessed June 10, 2009).

[167] P. Young and others, International Monetary Fund, "Dominican Republic: Selected Issues," October 1999, 15, http://www.imf.org/external/pubs/ft/scr/1999/cr99117.pdf (accessed June 10, 2009).

[168] John McCarthy, "Dominican Republic: Free Trade-Dismantling Barriers," *Foreign Direct Investment*, February 2007.

interest.[169] The closing of the three banks triggered mass panic and a second larger money rush throughout the country, as many people feared their banking institutions would be the next to close. The government was put in a very difficult position as to how they would try to contain the situation, and it was basically left with two choices. Either let the system run its course and potentially allow the crisis to destroy all the economic progress that had been made, or step in and formulate a bailout package, which would plunge the small nation into considerable debt.

The Dominican government weighed its options and chose to launch the largest depositor bailout in the nation's history. It was not limited to cover *Baninter*. It also included the closed *Banco Mercantil* and *Bancocredito*.[170] The decision took a controversial turn when the government decided to issue Central Bank certificates of deposits that would cover 100% of all the depositor's losses. [171] This proved to be a costly decision for the entire nation, which had to absorb a much higher price than just the guarantee of the lost deposits. The immediate ramifications of the bailout cost the nation US $2.2 billion or 20% of the nation's GDP, more than 100% devaluation of the DOP, an increased external debt of US$7.7 billion, an unemployment rate of 16.5 %, and a rate of inflation that skyrocketed to over 40%.[172]

Furthermore, the nation's economy continued on a downward tailspin because the Mejía Administration failed to comply with conditions that would release funds from the IMF's Standby Agreement.[173] The mishandling of the situation caused significant investment and capital flight at the same time that the nation was already suffering from the external pressures on its export industries.[174] This was an especially disconcerting

[169] Karen E. Thuermer, "Dominican Republic-Financial Services-Free Money," *Foreign Direct Investment*, December 2005.

[170] Jules Stewart, "Dominican Republic-Back In The Black," *The Banker*, September 1, 2007.

[171] Karen E. Thuermer, "Dominican Republic-Financial Services-Free Money," *Foreign Direct Investment*, December 2005.

[172] Jules Stewart, "Dominican Republic-Recovery Efforts Come to Fruition," *The Banker*, September 1, 2007.

[173] Claire M. Ribando, U.S. Foreign Affairs, Defense, and Trade Division, Congressional Research Service, *Dominican Republic: Political and Economic Conditions and Relations with the United States*, April 17, 2007, 4.

[174] Jules Stewart, "Dominican Republic-Recovery Ripples," *The Banker*, September 1, 2007.

situation for a nation that was trying to attract new sources of FDI to fuel its growth. The overall situation also didn't favor the country that was looking to establish a PTA with the U.S. and the CA nations, yet amazingly enough the DR displayed amazing resiliency and come back from what the IMF considered one of the major banking crises that was registered from 1970-2007.[175]

To recuperate from the debacle, the new government, once again under Leonel Fernández, negotiated with the IMF early in 2005 and earnestly accepted the conditions imposed by IMF's Standby Agreement. The US$665 million agreement was paid to the Central Bank and was directed towards strengthening the bank's reserves position and balance of payments. The program also opened up opportunities for new resources that totaled an approximate US$2.7 billion.[176] Although it was important for the nation to receive the necessary funds needed to stabilize the bleak situation, what was even more important for the long term were the steps taken to reform the entire banking institution. The IMF's stipulations required extensive changes in the banking sector's laws and procedures that included supervision and general audits by foreign banking specialists. The IMF also required that laws be passed, which set defined procedures for cases that presented systematic risk to the entire banking structure.[177]

Since 2005, President Fernández and the new Central Bank governor have implemented a new regulatory framework and restructured the banking supervisory body, which has led to increased accountability costs for all the banks. The steps to institutionalize modern and transparent banking transactions and the successful completion of the IMF agreement have restored public and international confidence in the financial sector in a fairly short time.[178] The reforms turned the economic situation around rather quickly despite higher oil prices and were reflected in remarkable GDP

[175] Anonymous, "Dominican Bank Frauds Among the World's Worst, IMF Confirms," *Dominican Today,* October 8, 2008, http://www.dominicantoday.com/dr/local/2008/10/2/29609/Dominican-bank-frauds-among-worlds-worst-IMF-confirms (accessed June 15, 2009).

[176] Jules Stewart, "Dominican Republic-Back In The Black," *The Banker*, September 1, 2007.

[177] Karen E. Thuermer, "Dominican Republic-Financial Services-Free Money," *Foreign Direct Investment*, December 2005.

[178] John McCarthy, "Dominican Republic: Free Trade-Dismantling Barriers," *Foreign Direct Investment*, February 2007.

growth of 9.3% in 2005, 10.7% in 2006, and 8.5% in 2007 (figure 3).[179] As Juan Arteaga, executive vice-president of DR bank *Grupo Progresso*, stated, "fiscal reforms…are important for the DR-CAFTA agreement. These reforms are necessary if we are going to be competitive with other nations. The new regulations through the superintendant of banks are very strict. But the banking industry is currently very stable."[180] The importance of the reforms and the quick recovery cannot be understated, as the DR moved towards its negotiations with the U.S. and CA nations. It was important for the nation to present a solid economic foundation before it opened its markets to the new FTA conditions, which presented the nation not only with new opportunities but also with considerable challenges to overcome. It was also important for the DR to commit itself to higher levels of transparency and anti-corruption measures that would be a keystone of the DR-CAFTA and would be codified in Chapter XVIII of the final text.[181]

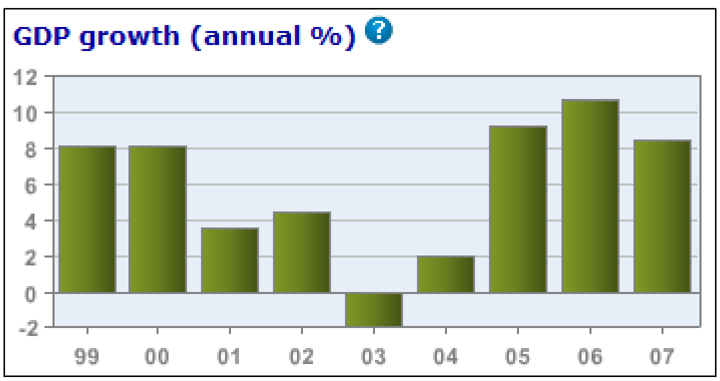

Figure 3. GDP Growth (From: Inter-American Development Bank, 2007)

F. CONCLUSION

For the DR, the road towards economic transformation was like a combustion engine that had several cycles of starts and stops along the way. During the 1980s, the

[179] Claire M. Ribando, U.S. Foreign Affairs, Defense, and Trade Division, Congressional Research Service, *Dominican Republic: Political and Economic Conditions and Relations with the United States*, April 17, 2007, 4.

[180] Karen E. Thuermer, "Dominican Republic-Financial Services-Free Money," *Foreign Direct Investment*, December 2005.

[181] Office of the U.S. Trade Representative, *DR-CAFTA Final Text*, http://www.ustr.gov/Trade_Agreements/Bilateral/CAFTA/CAFTA-DR_Final_Texts/Section_Index.html (accessed May 28, 2009).

fuels that had propelled the economy, i.e., primary exports such as sugar, gold, etc., were no longer globally demanded in the same quantities as they had been in the past. As has been the case for many developing nations, the overreliance on a small group of primary export products as the foundation of an economy can lead to periods of great successes and disasters. They key for the DR would have been to fully diversify the economy, during the 1970s, with the gains it had made from the high commodity prices. The early economic boom that lasted for four years saw the birth of the FTZs and tourism sectors, but at the time they were not major contributors to the overall economy. One of the major problems was that the "big government" practices infiltrated many aspects of the entire economy and latently undermined any success. The inefficiencies and legacy systems that were guided by the Balaguer Administration were hidden restraints that did not allow the structure to fully develop and advance. In the end the lack of external demand for primary exports, the great distortions within the ISI driven system, deficits in the balance of payments coupled with increased debt, and a lack of a flexible and realistic economic strategy brought the entire Dominican economy to a halt.

The DR was not left with many choices and was forced to undertake major reforms in order to revive the economy. Reforms, coupled with the CBI, provided the framework needed for the nation to shift its economy towards a more open and export oriented market. What became evident was that the DR was amenable to making changes to take full advantage of the opportunities the CBI presented. The country started to focus its energies towards the thriving export processing and tourism sectors, while it also sought opportunities in other nontraditional products. The economy was hindered by the poor policies taken by new Balaguer Administration, but the country was too far into its transformation to turn back to its previous state. The integration of the DR's economy to the region in the early 1990s was a step for the nation to become linked to the global economy, but the union had its price. The DR became exposed to the open market forces that drive supply and demand, and it was necessary for the nation react to the new changes that came with trade liberalization, and that included increased competition.

Increased reforms paved the way for further trade liberalization, privatization, and public sector modernization, which included increasing the quality of the DR's social services. The reforms were needed in order for the DR to maintain economic growth, and deal with the intense competition that was coming by the way of China and other Asian nations. Regional partnerships through alliances and PTAs with other nations in the Caribbean Basin and as components of the greater FTAA initiative became a way to combat the surging tide of Asian products. The U.S.'s involvement with the DR and the Caribbean, through the CBI, also became an increasingly important piece of the chess game in trying to avoid increased losses in the textile and apparel industries. The U.S. was willing to fortify the CBI to create and cement strategic partnerships that would prove beneficial to all parties involved. The DR was certainly in need of additional help to defend itself against the losses it had started to experience in the FTZ sector. The defensive strategy started by the CBI, although amplified, led the DR to seek a permanent solution to what appeared to be an ever increasing and changing problem. After firmly establishing itself as a service and export oriented economy, the DR needed to maintain an open outlet for its products and services. The establishment of a permanent PTA with the U.S. and CA would help it achieve this goal, but it would have to face a major economic crisis before it could take the country to the next level.

The economic crisis was devastating to the nation, but perhaps it brought out some of the weaknesses that the DR still needed to work on. It also proved once again, just as it did in the previous two decades, that true and genuine reforms go a long way in stabilizing a country and putting the economy back on the track of growth. The banking sector is one of the key elements within an economy that needs to have credibility and efficiency. It was crucial for the nation to weed out the bad practices that had been allowed to fester over time. The government also learned a harsh lesson about how its reactions to such a catastrophic event could have severe ramifications. Had the correct supervisory and regulatory mechanism been in place, the crisis could potentially have been contained to much lower levels. The nation was able to recuperate from the major setback and was able to prepare itself for the negotiation process it had originally sought with the U.S. and CA. The comeback was crucial for the DR. It needed to act in an expeditious manner before it not only lost jobs to China and Asia, but also before it was blocked out from attaining the future opportunities that were being presented to the members of the CACM. The DR faced certain challenges during and after the DR-CAFTA negotiation process, and it is important to understand how they affected the country. The nation had to make concessions to gain access to the newly created free trade area, while continuing to take on further reforms. It was also was expected that the DR would have the opportunities to achieve increased benefits in the long run. The latter will be the focus of the final chapter.

IV. DR-CAFTA & UNDERSTANDING THE ISSUES INVOLVED IN THE DR'S DECISION TO JOIN THE CAFTA NEGOTIATIONS

A. INTRODUCTION

The road towards economic transformation brought the DR towards a fork in the road at the turn of the 21st century. The country had taken the necessary steps towards getting away from its dependence on primary export products, but it had moved into a competitive environment that was quick to reward those nations that implemented change but also punished those that failed to adapt. The DR had achieved its goal of plugging its economy into the regional and global economic structure, but it needed to make choices that would help it maintain its growth. The DR had to make a choice among three major alternatives that would drive its future economic development; (1.) to maintain its current position and try find ways to overcome its declining position on its own; (2.). to seek a bilateral trade agreement with its major trading partner, the U.S.; (3) or to join the similarly endowed CACM nations in attempting to leverage a better position in establishing a regional trade agreement with U.S. It became clear to the DR that the losses that were being incurred by the cheaper goods coming from Asia and CA and the shifting of production to countries with lower wages were starting to mount.[182] Combined with the global textile and apparel quotas elimination that was quickly approaching in 2005, the leaders of the DR came to the realization that its economy was not as robust or dynamic enough to overcome the difficulties on its own.

For the Western Hemisphere nations, regionalization, fostered by the FTAA initiative, became the centerpiece of the strategy to deal some of the global economic pressures during the late 1990s. The DR made solid attempts to build strategic and economic partnerships within the Caribbean Basin through the CACM and CARICOM, and was able to attain further outlets for its products and services through the CBI, CBTPA, and CARIFORUM. Thus the trend of building subregional blocs that would feed into the potential FTAA and lock in the privileges of trade with the U.S. had

[182] Claire M. Ribando, U.S. Foreign Affairs, Defense, and Trade Division, Congressional Research Service, *Dominican Republic: Political and Economic Conditions and Relations with the United States*, April 17, 2007, 4.

tremendous influence on the DR. The DR also wanted the privileges attained under the CBI and CBTPA to become a permanent part of the nation's economic structure and developmental strategy. For the DR, the CBI, which had been enhanced in 2000 but which required periodic reauthorization by Congress, was a cause of major concern. In light of the changing economic conditions and pressures, it was important for the DR to lock in their accessibility to larger markets and continue to increase its opportunities to attract U.S. FDI. The latter investments were crucial in the strategic apparel and textile partnership that was a key component of the nation's export driven development strategy.[183]

In deciding amongst the three previous alternatives, the DR initially engaged the U.S. as an individual country seeking to establish a bilateral FTA. The U.S. Trade Representative (USTR) welcomed the possibility of establishing a comprehensive, mutually advantageous trade agreement with the largest CBI beneficiary. This was determined to be a progression under the CBTPA's structure. At the same time the USTR wanted to address the same disciplines or subjects as those included in the FTA that had been initiated with the members of CACM, while negotiating specific market access issues with the DR. The USTR also thought that in an effort to strengthen the economic ties between the DR, CA, and the U.S. and in order to present one FTA package to the U.S. Congress, it would be seek to integrate the DR in the CAFTA negotiations.[184] Although the U.S. initially negotiated a bilateral FTA with the DR, once the agreement was concluded it was easily docked it into the larger CAFTA. This arrangement was also beneficial for the DR, since it had already established a FTA with the CACM nations. The DR would not have to renegotiate terms and conditions with each individual CA nation, as would have been the case if the entities were covered under

[183] J.F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The Dominican Republic-Central America-U.S. Free Trade Agreement (DR-CAFTA),* January 3, 2005, 5.

[184] Office of the U.S. Trade Representative, *Letter to House Notifying Intent to Negotiate Free Trade Talks with Dominican Republic*, August 4, 2003, http://www.sice.oas.org/TPD/USA_CAFTA/Negotiations/USDR_announcetalks_e.pdf (accessed June 10, 2009).

separate FTAs. The inclusion of the DR into the CAFTA also helped open further opportunities to the DR to trade with the CA and further eliminate any tariffs and nontariff barriers that existed under the CA-DR FTA.

This chapter will provide a general overview of the DR-CAFTA, and look at the overarching goals that the FTA intends to achieve. The FTA provides increased opportunities for all sides, but the Caribbean nations face particular circumstances that will transform their economies tremendously once all the provisions are enacted. The DR-CAFTA was not just limited to trade, but also included essential provisions to address labor, corruption, transparency, the environment, and intellectual property rights (IPR). These factors were considered essential to maximizing the benefits that could arise from open trade and to aid development in certain areas. The next section will look at some of the issues the DR had to resolve during the negotiations process and during the implementation phase. This proved to be important as the DR delayed the enforcement of the FTA several times. The analysis will continue with a look at the DR's expected gains, losses, and challenges through this entire process. It is obvious that the DR entered the FTA believing that overall it would benefit from the arrangement, but it had to be willing to concede to several items. It will be important to look at how the nation plans to adapt and shift some of it important economic sectors. The DR will also have to constantly look at its upcoming challenges, which could include a second shift away or transformation from the *maquiladora* industry that is in continuous decline. Economic diversification is the key towards getting away from the dependence of any specific product or sector, and the DR has looked at further opportunities in the smaller business sector and nontraditional exports to continue to drive its economy. Just as the DR shifted away from its dependence on primary exports in the 1980s, it will be just as important for its leaders to note when it is time to introduce change or amend its export oriented economy.

B. THE DR-CAFTA

The DR-CAFTA is a comprehensive trade agreement whose stated aim is to liberalize the U.S., Dominican, and Central American markets, while creating a free trade zone similar to what was created in the NAFTA. It was specifically designed to "eliminate tariffs and trade barriers and expand regional opportunities for the workers, manufacturers, consumers, farmers, ranchers and service providers of all the countries."[185] The DR-CAFTA immediately eliminated tariffs on more than 80% of U.S. exports of consumer and industrial products, with the remaining tariffs being phased out in the ten year period following each individual country's enforcement date.[186] On the other side, the Caribbean nations were given 100% elimination on all non-textile and non-agricultural goods.[187] The negotiated agreement dealt with many sensitive subjects or disciplines, which affected all the parties involved. For the U.S., the overall balance of trade was not expected to affect its economy significantly, but the DR and CA were opening their nations up to changes that were expected to transform many sectors of their developing economies.

The market access issues involving agriculture and the textile & apparel industry were the most difficult to resolve, since the DR-CAFTA's provisions were aimed at reducing and eliminating trade barriers such as tariffs and quotas. It was decided that DR-CAFTA would remove all duties on textile and apparel items that fit under the agreement's rule of origin sections.[188] The latter provisions of the FTA were of significant importance since apparel and textiles were the biggest imports coming out of the DR and CA. In many cases Central American and Dominican apparel was already duty free under the CBTPA provided the yarn, and not necessarily the fiber (yarn forward rule), had originated in the U.S. The DR-CAFTA incorporated provisions that allowed the limited use of yarns in the assembly process from NAFTA and third party nations in order to compete with apparel originating in Asia. Although these rules were adopted,

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[185] Office of the U.S. Trade Representative, *DR- CAFTA Final*, http://www.ustr.gov/Trade_Agreements/Bilateral/CAFTA/CAFTA-DR_Final_Texts/Section_Index.html (accessed May 28, 2009).

[186] The CAFTA Intelligence Center, "What is CAFTA?" http://www.caftaintelligencecenter.com/subpages/What_is_CAFTA.asp (accessed May 28, 2009).

[187] J.F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The Dominican Republic-Central America-U.S. Free Trade Agreement (DR-CAFTA),* January 3, 2005, 19.

[188] Office of the U.S. Trade Representative, *DR- CAFTA Final Chap. Text Chap. 3-Section G*, http://www.ustr.gov/Trade_Agreements/Bilateral/CAFTA/CAFTA-DR_Final_Texts/Section_Index.html (accessed May 28, 2009).

some textile producers complained that the rules were still too restrictive and did not open up the markets enough to allow for effective competition with other markets.[189]

1. Agriculture

The DR-CAFTA's provisions concerning agriculture will have a major impact on the DR and CA nations. The Latin American nations felt extremely vulnerable during the negotiations due to the threat that the importation of key staples from the U.S. such as corn, rice, and beans poised. The leaders thought that an uncontrolled influx of basic foodstuffs could quickly overwhelm the DR and CA markets and cause massive displacement issues.[190] Yet one of the underlying pillars of the FTA was to shift the DR and CA nations away not only from traditional export products but also from certain less profitable domestically consumed agricultural products. It is envisioned that the DR and CA will eventually replace traditional subsistence farming with value added agribusiness operations, which will allow many affected agricultural jobs to shift towards manufacturing and services. It is expected that when the FTA is completely enacted all agricultural trade will be tariff free except for imported sugar by the U.S., potatoes and union growing in Costa Rica, and white corn in all of the Central American nations.[191] This is clearly a major change for the region, since agriculture continues to be a significant source of income and employment for many of the people in the area.

The DR-CAFTA didn't include provisions for domestic support programs, but it did provide generous transition schedules to all the countries for sensitive agricultural products and the option to use special safeguard measures. Agricultural products have the most liberal tariff phase out schedules, with up to 20 years for certain items. This approach to the transformation was a way to prepare the countries that were heavily dependant on small and medium farming to generate plans to accommodate the structural adjustment. Although the transition period is fairly long there are still major concerns

[189] J.F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The Dominican Republic-Central America-U.S. Free Trade Agreement (DR-CAFTA),* January 3, 2005, 19.

[190] Ibid., 7.

[191] J.F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The Dominican Republic-Central America-U.S. Free Trade Agreement (DR-CAFTA),* January 3, 2005, 19.

due to the ill effects U.S. subsidized products could have on the entire region.[192] For the DR and CA it was important to learn the important lessons from the NAFTA and how the similar arrangement of market liberalization affected Mexico. Just as in the DR-CAFTA nations, the vast majority of Mexican farmers cultivated medium and small sized farms that usually dealt with fewer technological inputs and were not able to compete with the large scale and highly subsidized agribusiness giants of the U.S. and Canada. Many Mexican farmers were forced to grow nontraditional crops and even diversified their incomes through the use of grazing. Others attempted to increase their yields by increasing the use of pesticides, herbicides, and fertilizers, which has caused significant damage to the environment.[193] These are scenarios that are likely to repeat themselves in the DR-CAFTA context if the leaders of the nations don't play an active role in addressing these problems from their inception.

2. Labor

Other major areas associated with the new liberalization process were labor and the environment. In many ways the fact that these issues were being brought up indicates that the DR-CAFTA was going beyond trading factors and was trying to engage the social policies that needed to be enacted to promote effective liberalization policies. It was agreed that is was important to make provisions in the agreement that would address these concerns, but initially there was disagreement as to how aggressive the content of the charter should be.[194] It can be argued that trade liberalization, left to run its own course, will lead to increases in standards of living for all. But as is frequently seen in Latin America, increases in inequality are often seen side by side with overall economic growth. In order to address the labor and environmental issues all the parties agreed to abide by the rules of the International Labor Organization (ILO) and uphold their

192 Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, 20.

193 Washington Office on Latin America. Latin America Working Group. "Fair Trade or Free Trade? Understanding CAFTA" December 2003, 18, http://www.wola.org/media/Rights%20and%20Development/cafta_briefing_packet_final_dec03.pdf (accessed June 10, 2009).

194 J.F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The U.S.-Central America Free Trade Agreement (CAFTA): Challenges for Sub-Regional Integration,* June 1, 2004, 23.

commitments to the ILO Declaration on Fundamental Principles and Rights at Work and its Follow Up. Nevertheless, the opponents of the agreement in the U.S. questioned whether the DR and CA could effectively live up to the standards.[195]

Two main themes came to the forefront during the negotiations related to labor standards in the DR and CA nations, which were considered weak. The first issue was to what extent the DR and CA had adequate labor laws, and the second was whether the DR-CAFTA could meet the standards set by the Trade Promotion Authority (TPA). U.S. labor advocates thought that some DR-CAFTA nations lacked the proper protection for worker's rights in their labor codes, and even if the laws existed many of the enforcement mechanisms are nonexistent.[196] In order to demonstrate that the DR and CA were in compliance to the ILO's mandates the nations requested that the ILO conduct a study of the labor laws, and it was concluded that the principles were guaranteed either through the constitutions or enacted laws. The DR-CAFTA nations have admitted in their individual reports that they lacked the financial resources and expertise to enforce good labor practices, and that perhaps the DR-CAFTA could be used to achieve higher standards through the Labor Cooperation Building Mechanism that is included in the Labor section (16.5) of the agreement.[197]

In part there needs to be a clear understanding of the nature of labor within the DR-CAFTA nations. In general the DR-CAFTA nations didn't develop strong labor parties or unions in the past. In many cases, unions and labor associations provide the lines of communication between workers and management and define worker rules, but in the DR and CA many of these same groups are seen as corrupt and inefficient. In the DR, Ignacio Hernández, the General Secretary of the Dominican Federation of Free Trade Zone Workers (FEDOTRAZONAS) stated in 2005, "Here the term 'freedom of association' is devoid of meaning. It merely exists on paper in the law and in the

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[195] Office of the U.S. Trade Representative, *DR- CAFTA Final Text, Chapter 16.1*, http://www.ustr.gov/Trade_Agreements/Bilateral/CAFTA/CAFTA-DR_Final_Texts/Section_Index.html (accessed May 28, 2009).

[196] J.F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The Dominican Republic-Central America-U.S. Free Trade Agreement (DR-CAFTA)*, July 6, 2005, 27.

[197] J.F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The Dominican Republic-Central America-U.S. Free Trade Agreement (DR-CAFTA)*, July 6, 2005, 28.

Republic's Constitution, but not in practice. Any worker who makes a fuss and starts making demands is immediately sacked under some pretext."[198] FTZs are areas that are particularly prone to labor abuses as firms refuse to recognize unions, distribute blacklists of union activists, and force workers to work extended hours with out extra pay. In the DR and CA many people that would otherwise lack jobs are compelled to accept substandard conditions in order to earn enough to feed their families. [199]

3. Democratic Institutions & Poverty Reduction

Many proponents of the DR-CAFTA looked at broader geopolitical and strategic concerns such as fighting terrorism, organized crime, and drug trafficking, but to many an important expectation of the DR-CAFTA was to try to reinforce stability by providing the institutional structures that will help build democracy and reduce poverty. DR-CAFTA is expected to provide the mechanisms needed to increase political and economic stability by supporting the rule of law. As governments, markets, and civil society combine their efforts through democratically supported practices the region will hopefully become more stable, predictable, and economically integrated, while providing greater economic prospects at home.[200] In an effort to provide one of the foundations of democracy, Chapter 18 of the FTA spells out specific rules concerning transparency objectives for transactions conducted between all the nations involved. The section specifically requires all nations to publish or make available any laws, regulations, procedures, and administrative rulings of general application respecting any manner covered by this agreement. It forces all parties to establish or maintain judicial or administrative tribunals or procedures for the purpose of prompt review, and where warranted correction of final administrative actions regarding the agreement. There are also provisions to try

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198 International Confederations of Free Trade Unions, "Dominican Republic: Annual Survey of Violations of Trade Union Rights (2006)," June 7, 2006, http://www.icftu.org/displaydocument.asp?Index=991223954&Language=EN (accessed March 29, 2009).

199 Ibid.

200 The CAFTA Intelligence Center, "What is CAFTA?" http://www.caftaintelligencecenter.com/subpages/What_is_CAFTA.asp (accessed May 30, 2009).

to eliminate bribery and corruption in international trade and investment.[201] For democracy to flourish these are important elements, but one major flaw of the agreement is that it does not specifically spell out provisions as to how the DR-CAFTA will actually help to solidify democracy. In many cases the reinforcement of democratic institutions is expected to be a natural offspring of the covenant without setting out clear procedures and time-dated goals for the progress to occur.

To make significant inroads against poverty and aiding the rural sector, the U.S. government has provided more than $650 million dollars in trade related assistance to the DR-CAFTA nations since 2003. It is an effort to help support rural development and reduce poverty. Through the Millennium Challenge Corporation (MCC), Honduras, El Salvador, and Nicaragua have received money to help improve rural roads and highways, education, and enterprise development. The DR and Guatemala have not qualified for the MCC, but through USAID they have received increases of $10 million dollars since FY 2007 that are aimed at promoting rural electrification and development of small rural business and agribusiness. Other examples of support for the poor sectors in the DR-CAFTA nations include U.S. Department of Agriculture (USDA) assistance to small farmers to develop local, regional, and international markets for their products and the support in the construction of irrigation and other infrastructure to allow farmers to compete in global markets.[202] These aid packages are closely linked to the DR-CAFTA, but they are not direct improvements caused by the benefits of being involved in the FTA. It will be important to closely monitor the changes in agriculture, especially when the major shifts, due to agribusiness, start to take their tolls. The aid programs help the poor and the rural sectors, but it will be important to transition many of the citizens involved in agriculture towards other employable and productive sectors of the economy.

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201 Office of the U.S. Trade Representative, *DR- CAFTA Final Text, Chapter 18,* http://www.ustr.gov/Trade_Agreements/Bilateral/CAFTA/CAFTA-DR_Final_Texts/Section_Index.html (accessed May 28, 2009).

202 Office of the U.S. Trade Representative, *Promoting Rural Development in CAFTA-DR Countries,* July 2007 http://www.ustr.gov/assets/Trade_Agreements/Bilateral/CAFTA/Briefing_Book/asset_upload_file544_13195.pdf (accessed May 28, 2009).

C. ISSUES DURING THE NEGOTIATION AND IMPLEMENTATION PHASES

The negotiations to form the U.S.-DR FTA were initiated under the careful guidance of the USTR, Robert B. Zoellick, in January of 2004. Although the U.S.-DR FTA was negotiated separately and subsequently drafted in the spring of 2004, the FTA was negotiated with the expectation of integrating it with the CAFTA.[203] All the parties were able to come to a consensus to include the DR by August of 2004, but even after the FTA was signed by all the associated nations there were several contentious points that almost prevented the DR from being integrated to the new scheme. The greatest threat to the DR's inclusion came to light when the DR included a provision in the Fiscal Reform Law of 2004 that would add a 25% tariff on all imported U.S. beverages containing corn syrup as a sweetener.[204] This was a controversial move, which gained support in the DR Congress after many sugar producers demanded increased protection from foreign imports. The producers claimed that the introduction of imported corn syrup sweetened beverages would cause an approximate loss of 17% of the local market.[205] The key issue with this law, which was surprisingly supported by the reformist President Fernández, was that it went against the main principles associated with a FTA. It was expected that DR would allow open markets and free competition to replace protectionist practices in the newly created space, yet this was a good example of the problems the nation would have to face under the new framework. The sugar industry exerted pressure on the DR Congress, but in the new era the ramifications of such actions were much higher than expected.

The expected backlash from the U.S. came almost immediately, and in an official statement Zoellick clearly stated, "Inform President Leonel Fernández that I cannot recommend the DR for inclusion in the free trade agreement package if the tariff on corn

[203] J.F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The U.S.-Central America Free Trade Agreement (CAFTA): Challenges for Sub-Regional Integration,* June 1, 2004, 17.

[204] Anonymous, "Representante de EEUU insiste en sacar a Dominicana del CAFTA," *El Financiero*, November 21, 2004.

[205] Tania Polanco, "EEUU rechaza impuesto de Republica Dominicana a bebidas edulcoradas," *El Nuevo Día*, December 6, 2004.

sweetened beverages is applied."[206] At the time the USTR was dealing with the U.S. Congress, and he was not willing to hold back the process for one nation. Some U.S. congressmen advocated the DR's inclusion, but at the same time questioned the country's commitment to free trade due to the tariff measure.[207] It was clear that a demarcation line had been drawn, which caused the DR government to reconsider its options. It became obvious that the price of maintaining the tariff and being excluded from the DR-CAFTA would have been disastrous to a nation that was trying to recover from a major economic crisis. At the same time other issues also loomed on the horizon such as the world textile and apparel quotas elimination, which were already expected to affect the country. In the end the DR acceded to the USTR's position and removed the protectionist measure, but the lesson learned was that it would be impossible in the future to try to protect certain sectors that were not competitive and could not adjust to new circumstances.

The DR-CAFTA was scheduled to come into force once the U.S. and any other signatory had officially declared that they had completed all the required legal procedures according to the charter. The original dateline was set for January 1, 2005, but the proceedings through the U.S. Congress took longer than expected. All the member nations, except for the DR and Costa Rica, were able to get their legislative bodies to pass the agreement by the time President George W. Bush issued Proclamation 7987 implementing the FTA on February 26, 2006.[208] It is interesting to note that it was the two largest Caribbean economies that had the most difficulties in meeting all the requirements to enforce the FTA in their respective countries. Although the passage of the FTA was not as controversial in the DR as it was in Costa Rica, there was a significant lag between the time the DR's Chamber of Deputies sent the approved agreement to the president and when he finally signed it. The period lasted from September 6, 2005 until March 1, 2007, and the impasse caused significant worries

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206 Polanco, "EEUU rechaza impuesto."

207 Anonymous, "Representante de EEUU insiste en sacar a Dominicana del CAFTA," *El Financiero*, November 21, 2004.

208 Organization of American States, Foreign Trade Information System (SICE), *Trade Policy Developments: Central America-Dominican Republic-United States*, http://www.sice.oas.org/TPD/USA_CAFTA/USA_CAFTA_e.ASP (*accessed* May 31, 2009).

among many investors. Even before that period, Arturo Peguero, President of the Dominican FTZ Association (ADOZONA), stated, "70% of new businesses that started the installation processes in the FTZ parks have suspended their operations until the impasse was overcome."[209] This lag most likely caused an undetermined amount of businesses and investors to shift their investments towards the CA countries that were prepared to take advantage of the new trade zone.

The DR and the U.S. had multiple issues after the corn syrup debate that needed to be resolved before the two nations were ready to enforce the agreement. The initial delays were caused by the USTR's questioning of the 2% tariff levied on all imported goods and the 13% monetary exchange commission that was being charged to conduct business using the DOP. The latter two were resolved with relative ease as the government took the proper steps to remove them, but other problems would arise. The next major concern involved a selective consumption tax on all imported vehicles for a period of 10 years, instead of the agreed 5-year limit set in the DR-CAFTA. The USTR questioned the tax based on the limitations placed on 5-ton vehicles, and on the subjectivity used to enforce the tariff. The consumption tax issue was resolved early in 2007 when the DR Congress amended the fiscal resolution that included the stipulation.[210] Some observers claimed that the Dominican government was attempting to seek concessions from the U.S. government in an attempt to protect local businesses, but the government did try to take a firm stance against Chevron Caribbean.[211] This became one of the hardest issue to resolve and dealt with specific labor practices in the fuel transportation sector, which affected the application of Norm 148 put into practice by the DR Secretary of Commerce and Industry (SEIC).[212]

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[209] Tania Polanco, "EEUU rechaza impuesto de Republica Dominicana a bebidas edulcoradas,*"El Nuevo Día*," December 6, 2004.

[210] Cándida Acosta, "Nuevo obstáculo de EEUU frena entrada del DR-Cafta," *Listín Diario*, January 10, 2007, http://www.listin.com.do/app/article.aspx?id=174 (accessed May 31, 2009).

[211] John McCarthy, "Dominican Republic: Free Trade-Dismantling Barriers," *Foreign Direct Investment*, February 2007.

[212] Cándida Acosta, "Nuevo obstáculo de EEUU frena entrada del DR-Cafta," *Listín Diario*, January 10, 2007, http://www.listin.com.do/app/article.aspx?id=174 (accessed May 31, 2009).

The last hurdle for the DR was the dispute triggered when Chevron Caribbean, a long established firm in the DR, decided that as part of its optimization plan it would discontinue all local transportation contracts and replace them with their own fleet of carriers and drivers. The decision by Chevron Caribbean caused the SEIC to issue two resolutions that regulated the domestic transportation of fuels within the DR. These measures were appealed by Chevron Caribbean through the USTR, which was quick to claim that resolutions were not in accordance with the obligations assumed by the DR in the DR-CAFTA. Yet the DR government stood firmly behind its position in making sure that Chevron Caribbean implemented its optimization plan in a gradual manner, which would help the laborers transition their services towards other enterprises. In the end Chevron Caribbean agreed to accept a postponement in the implementation of its program until 2008, and introduce gradual measures that would not cause abrupt shock to the fuel transportation sector.[213] In a further step, Chevron Caribbean went on to negotiate a settlement with the DR Autonomous Workers Union of Fuel Drivers and Associates in 2009. The arrangement awarded the union DR$19 million in workers' compensation pay, an agreement to contract a certain percentage of local drivers, and aid in helping to find discharged drivers employment in other companies.[214] This step helped to demonstrate the importance of achieving and retaining partnerships that can help address the needs of all the parties involved. It also went a long way to trying to develop and promote solutions to some of the social problems that will arise with trade liberalization.

With the enactment of the final two legal amendments that produced changes to Dominican Law in January of 2007 and the resolution of the transportation dispute in the following month, the DR was finally ready to implement the anticipated DR-CAFTA. The FTA went into force on the March 1, 2007, after years of negotiations and multiple delays. Many FTZ industrialists had been impatiently waiting for the agreement to go into effect, especially since as their businesses were suffering through a major economic

213 Ramón Urbáez, "Afirma el camino para el DR-CAFTA está despejado," *Listín Diario,* February 22, 2007, http://www.listin.com.do/app/article.aspx?id=4008 (accessed May 31, 2009).

214 Deyanira Polanco, "Chevron pagará RD$19 millones prestaciones transportistas," *Listín Diario*, March 27, 2009, http://www.listin.com.do/app/article.aspx?id=95756 (accessed May, 31, 2009).

downturn. ADOZONA was a major proponent of the DR-CAFTA and had been calling for the immediate entry into force of the FTA as it saw many companies within the industrial complexes close. Nationwide the *maquiladoras* had been experiencing major contractions and adjustment issues, and it was hoped the DR-CAFTA would alleviate many of the losses. The question being asked was whether it was too late to combat the surging trend? The DR government promised that it would enact laws to exempt FTZs from paying taxes on transfers of goods and services, corporate taxes, and custom tariffs in an effort to increase the levels of competitiveness from the enterprises.[215] Yet the government's action really seemed more like a defensive tactic to combat the imminent conditions that the nation was facing. What was more important to understand was what the DR expected to gain and lose in the long term by joining the FTA and what would be the challenges in achieving the desired results.

D. EXPECTED GAINS AND LOSSES

In the DR and the rest of the CA nations there was much debate surrounding the gains and losses revolving around the DR-CAFTA. Many analysts used their own subjective formulas to dissect the ramifications for the DR in the long term. Hornbeck concludes that the primary gain that drove the DR's decision was the reduction in barriers to the U.S. market, especially for textile and agricultural products.[216] The author feels that access was cause enough, and it is certainly true that the future of the textile and apparel component was a major part of the decision. But in looking at all the evidence Jesus de los Santos, DR National Competitive Council (NCC), captured the essence of the argument when he said, "DR-CAFTA is not a solution, but it's a tool we can use for the benefit of the DR. If we can't provide the proper trade and legal environment, then we won't see the benefits. DR-CAFTA gives us the opportunity to do things right."[217] The DR-CAFTA was not meant to be the universal remedy that would solve for the DR's

[215] Anonymous, "Free Trade Agreement DR-CAFTA Enters into Force After Years of Negotiations, " *Inter Press Service*, March 1, 2007.

[216] J.F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The Dominican Republic-Central America-U.S. Free Trade Agreement (DR-CAFTA)*, July 6, 2005, 7.

[217] John McCarthy, "Dominican Republic: Free Trade-Dismantling Barriers," *Foreign Direct Investment*, February 2007.

problems, but it did provide the country a larger space that could help it develop many of the nation's sectors. It was certainly true that the DR could achieve its desired goals through the FTA, but only if the nation, as a whole, undertook all the necessary steps and adjustments needed. The country was running in a global race, where it needed to retain and explore new venues that would help it maintain its competitive advantages. The fact that the DR was one of the last signatories of FTA put it a position where it had to halt any further momentum that was taking businesses away to other countries, including its new CA partners.

The DR wanted to keep its established opportunities opened, and by entering the DR-CAFTA it took away the conditionality involved under the CBI relationship. Under the DR-CAFTA there was no possibility that the DR would lose the preferential treatment status assigned to its products and services. Since the FTA rules were set and codified, this created an environment of increase stability for both domestic and foreign investors.[218] For the DR, the importance of long-term stability was deemed necessary to encourage and promote increases in FDI, which under the *maquiladora* relationship had helped to fuel its export driven development strategy.[219] A constant increase in FDI was one of the largest opportunities that the DR was hoping to capture through the DR-CAFTA. It was expected that FDI from the U.S. and other DR-CAFTA nations would increase once all the protections and incentives provided by the regime were established. With the new influx of FDI, a certain level of confidence could be established that would prevent many companies from closing down their operations and setting up their shops in China.[220] Mr. Ortega, a DR official, claimed that the government was definitely optimistic about the new prospects and affirmed, "DR-CAFTA will make access to the

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218 John McCarthy, "Dominican Republic: Free Trade-Dismantling Barriers," *Foreign Direct Investment*, February 2007.

219 J.F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The Dominican Republic-Central America-U.S. Free Trade Agreement (DR-CAFTA)*, July 6, 2005, 7.

220 Erika Morphy, "Dominican Republic: US trade-One by One," *Foreign Direct Investment*, December 2005.

U.S. market permanent and give us the tool to confront all the challenges we are facing with the growth of China's exports, particularly to the U.S."[221]

The DR wanted to provide a positive investment environment that would attract FDI, but in order to create that possibility it had to take on significant institutional reforms to change the way investors perceived the nation. Although the DR-CAFTA specifically required certain reforms that were made through changes in laws, the nation could no longer afford to stall on their implementation and expect to remain competitive.[222] Institutional changes are considered both a gain and a challenge for the nation. The country has had a reputation for dubious dealings in the past, but with the new laws enacted, there is a clear obligation to adhere to transparent and corrupt free practices.[223] One of the areas where the DR government had to make significant changes concerned the rules that determined government procurement practices. Under the new framework public bidding is mandatory for the acquisition of services that exceed certain threshold limits as delineated in the DR-CAFTA charter. The latter introduces the possibility of having international proposals competing with local offers, which will help fight a perennial source of mismanagement and corruption.[224]

The institutional reforms enacted to revamp the banking system and the subsequent results paid major dividends towards paving the way for new sources of FDI. For the DR, the rapid recovery from the 2003-2004 banking crisis has translated into higher levels of private consumption and investments. Vincente Bengoa, DR Finance Minister, reported that in 2006, private investment grew 20%, while private consumption increased an average rate of 10.7 % during the 2004-2006 period.[225] The investment and consumption increases would not have been made possible if it were not for the IMF required changes to the laws and procedures that included supervision and audits. The

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[221] Karen E. Thuermer, "Dominican Republic: DR-CAFTA-Joining the CAFTA Club," *Foreign Direct Investment*, December 2005.

[222] Karen E. Thuermer, "Dominican Republic: DR-CAFTA-Joining the CAFTA Club," *Foreign Direct Investment*, December 2005.

[223] Anonymous, "Dominican Republic-New Scene Set For Trade," *The Banker*, April 3, 2006.

[224] John McCarthy, "Dominican Republic: Free Trade-Dismantling Barriers," *Foreign Direct Investment*, February 2007.

[225] Anonymous, "Recovery Ripples," *The Banker,* September 3, 2007.

new regulatory framework and the restructuring of the supervisory body has led to increased compliance costs, but has helped to restore confidence for foreign and domestic investors. Juan Jose Arteaga, Vice-president of *Grupo Progresso*, believes that the positive investment environment will attract more foreign banks to the DR, and that nation is willing to accept the challenges of international practices such as mergers and acquisitions, which have never been part of the DR's banking history.[226] With the institutional reforms set in place and the enforcement of the DR-CAFTA in effect, the nation is expected to progress into a new era of development and growth.

There are other areas in which the DR will have to make institutional changes to attract FDI, but the increased FDI is a means towards a greater end. The DR is expecting that the DR-CAFTA and the new FDI will create jobs and help reduce the high levels of poverty and the major migration problem that continuously concerns Dominican citizens.[227] These problems have been an integral part of the country's history, and many governments have failed to make substantial strides in containing the correlated issues. One of the ways that new jobs can be created is by having industries become integrated "vertically backwards." This simply translates to having more companies in the DR becoming involved in the intermediate phases of production. One of the downsides to the *maquiladora* set up is that there is little value added to the end products. Many of the DR's exports fell under this scenario since all that was required in the local factories was the final step of assembly. Companies and firms will now have the ability to shift more of the phases of production to the DR, since according to Bengoa, "this [shift] wasn't feasible within such a small market as the DR's alone, but it is now that we'll have free access to the U.S. market."[228] The increase in production in exportable and domestically consumed goods and services will help to generate more productive employment prospects for Dominicans. The FDI is also expected to be vectored towards other

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[226] John McCarthy, "Dominican Republic: Free Trade-Dismantling Barriers," *Foreign Direct Investment*, February 2007.

[227] Luis E. Núñez Santana, "Beneficios y Desafíos Económicos del DR-CAFTA," *Listín Diario,* March 24, 2007, http://www.listin.com.do/app/article.aspx?id=7222 (accessed June 2, 2009).

[228] Anonymous, "Dominican Republic- Membership with Privileges," *The Banker*, February 5, 2007.

important national sectors other than the exports, such as technology, agriculture, science and other activities that will ensure the profitability and security of investments.[229]

As the DR-CAFTA starts to take it effects on the DR economy, consumers and exporters are expected to attain significant gains. Consumers are expected to see an increased variety and quality of domestic and foreign products and services due to the increased availability created in the larger trading space. The latter will be combined with lower prices as Dominican products and services will begin to compete with the foreign alternatives. With the enlarged market, exporters will have the opportunity to significantly improve the quality of products designed for exportation, while taking advantage of the nation's comparative advantages. The increased quality demands will help Dominican exporters satisfy the demands of the larger international market. Finally, the DR will be able to take advantage of economy of scales, since it will be in a position to overcome the limitations imposed by the much smaller domestic market. With the new trade area, which will be devoid of the previous tariffs and restrictions, many Dominican companies will have the ability to market and sell their goods on a much larger spectrum and scale.[230]

All of the mentioned gains are based on opportunities that are highly dependant on the will of the entire nation in taking the initiative. What is certain is that there are going to be tangible and definitive losses incurred by the DR. One of the largest losses associated with the liberalization process was tied to the elimination of tariffs. The DR's economy was under considerable restrictions as it climbed out of the 2003-2004 crisis, and the government will have to continue to measure its policies as the expected losses of tariff revenues would put further strains on the nation's treasury.[231] For the DR government, the two major components that were eliminated were the 13% monetary exchange commission and the 2% tariff levied on all imported goods. As mentioned before, the removal of the tariffs was a prerequisite condition to allow the DR to enter

[229] Luis E. Núñez Santana, "Beneficios y Desafíos Económicos del DR-CAFTA," *Listín Diario,* March 24, 2007, http://www.listin.com.do/app/article.aspx?id=7222 (accessed June 2, 2009).

[230] Luis E. Núñez Santana, "Beneficios y Desafíos Económicos del DR-CAFTA," *Listín Diario,* March 24, 2007, http://www.listin.com.do/app/article.aspx?id=7222 (accessed June 2, 2009).

[231] Erika Morphy, "Dominican Republic: US trade-One by One," *Foreign Direct Investment*, December 2005.

into the FTA, and there was no way to get around it. At the time the exchange rate tax was the government's third largest income source and together with the general tariff they generated US$900 million, which was equivalent to 3% of the DR's GDP. This was a substantial amount of money that the DR government would have to try to make up, and it was looking at the possibility of implementing a value added tax (VAT).[232] The logical problem with the VAT is that due to its nature it would offset the gains made through competitive price reduction, and its revenues would fluctuate with the amount of domestic consumption.

Another area of major losses for the DR will be in the agricultural and livestock sector. The DR's agriculture is expected to be seriously challenged by the DR-CAFTA, although as previously mentioned there are specific provisions and phased timelines in the agreement that provide protection for staple products.[233] The protections will be scaled down over a 20 year period, but there is no way to escape the fact that certain subsectors will be eliminated at the end of the process. The DR's agricultural and livestock sectors have traditionally been small and technologically limited, and in the past have not had to compete with foreign imports. They usually catered to a small market, and with the opening of the market will not be able to take advantage of economies of scale.[234] For the DR the major issue is that the U.S. agricultural sector receives subsidies and is so immense that there is no possibility that DR farmers will be able to compete. The agricultural and livestock sectors will have to result to substantial repositioning, which will led it down the path of searching for niche markets.[235]

The search for niche markets is not a new concept for DR, which started to develop nontraditional exports when the CBI was originally introduced in the 1980s. The 20-year phased schedule for agricultural products and livestock was specifically designed to allow the DR-CAFTA countries to diversify towards nontraditional exports and away

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232 Karen E. Thuermer, "Dominican Republic: DR-CAFTA-Joining the CAFTA Club," *Foreign Direct Investment*, December 2005.

233 Anonymous, "The Challenge of CAFTA," *Latin Finance*, September 2005.

234 Anonymous, "Dominican Republic- Membership with Privileges," *The Banker*, February 5, 2007.

235 John McCarthy, "Dominican Republic: Free Trade-Dismantling Barriers," *Foreign Direct Investment*, February 2007.

from subsistence agriculture and textile manufacturing, as part of a strategy of diversification and development.[236] Fortunately for the DR, during President Fernández's first term in office, national leaders from the government and business sector came together to form a strategic partnership, the NCC. This group was formed to address the issues of competitiveness in the emerging global trading environment. The NCC understood that the DR would be facing constant pressures as its economy became more integrated in the global market, and it looked for ways different ways to strengthen the DR's capacity to take advantage of new market access opportunities. The NCC played an active role during the DR-CAFTA negotiations, and specifically targeted the agro-industry sector. The partnership formulated plans to help shift the agricultural and livestock sector by establishing agricultural clusters that provided the proper technical assistance to address issues not covered under the CBI. A major part of the process was to make sure that Dominican produce was meeting international standards, such as the proper sanitary, phyto-sanitary, and safety conditions. The NCC is focused on developing niche markets, where the country can compete with high value added products, like organic products.[237]

With a new focus placed on this repackaged form of development, the DR has aggressively taken the proper steps to capitalize on the new economic openings. While the NCC has been highly influential, the growth in niche markets has also been spurred by the DR government's partnership with the Dominican Agrarian Institute (IAD), the *Banco Agricola* (Agricultural Bank), and the *Reforma Agraria* (Agrarian Reform Association). The institutions have expended substantial energy in building up the DR's capacity to produce a wide range of nontraditional crops, which are grown in controlled environments such as greenhouses. In 2007, the DR had 300 greenhouses that were producing sweet peppers, cherry tomatoes, cucumbers, and other varieties of specialized

[236] J.F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The Dominican Republic-Central America-U.S. Free Trade Agreement (DR-CAFTA)*, July 6, 2005, 7.

[237] John McCarthy, "Dominican Republic: Free Trade-Dismantling Barriers," *Foreign Direct Investment*, February 2007.

fruits and vegetables. The destiny of a good part of the produce was intended to meet the demands of the American and European markets, and the DR had a plan to increase the land used for the new enterprises by 30% in 2008.[238]

Although the majority of nontraditional exports are targeting large markets, the DR is also establishing venues to use the DR-CAFTA and the DR-CARICOM FTA to export items, such as organic garlic, to CA, Puerto Rico, and the smaller Caribbean islands. The latter countries have large tourism sectors that create a demand for such products, and the DR is in a position to capture a good part of that market.[239] The DR government has facilitated the new industry by opening up the path for traditional producers to become competitive exporters. The IAD, working with the government, has been quick to determine what exports are competitive, while *Banco Agricola* is providing the needed loans to launch the transformation. In total, the DR has seen the initial success of the changes on a small scale, and it poised to gain a larger share of the specialized markets. As Salvador Jimenez, the Secretary of Agriculture, assured reporters, "the production of nontraditional exports in controlled environments is the FTZ of the future…although we are currently using 1.2 million square meters for production, our goal is reach 1.8 million square meters."[240]

E. FUTURE CHALLENGES

The DR has the potential and the ability to take full advantage of the opportunities offered by the DR-CAFTA, but they will have to address and confront several challenges in order to attain the maximum effects possible. In looking at all the challenges that must be addressed, managing the high expectations that have been advertised through the agreement will possibly be the hardest issue the DR government will have to face. There are many people expecting an explosion of jobs to surge into the country, and after years

[238] Modesto Rodriguez, "Ven en plasticultura futuro para sector agrícola criollo," *Listín Diario*, August 31, 2007, http://www.listin.com.do/app/article.aspx?id=26672 (accessed June 3, 2009).

[239] Modesto Rodriguez, "Constanza se prepara para exportar vegetales al Caribe," Listín Diario, April, 21, 2007, http://www.listin.com.do/app/article.aspx?id=10190 (accessed June 2, 2009).

[240] Modesto Rodriguez, "Ven en plasticultura futuro para sector agrícola criollo," *Listín Diario*, August 31, 2007, http://www.listin.com.do/app/article.aspx?id=26672 (accessed June 3, 2009).

to hearing promises, Dominican citizens will have little tolerance for mediocre results.[241] The DR is expecting to grow and attract more investments, but the nation's key sectors need to come together to provide a collective strategy to deal with issues that will arise. The latter was a specific issue that David Díaz Benavides, a renowned international consultant, addressed in the *Listín Diario's* Globalization Conference in the summer of 2007. Díaz Benavidez stated that the first effect that the DR would experience under the DR-CAFTA is an increase in the amount of investments in the country, which would only be distributed effectively and evenly across the many sectors of the economy if the nation has a defined strategy on how to channel the benefits. At the time the DR lacked what Díaz Benavidez called a "skyscraper approach." The latter developmental strategy that focuses on each economic sector and sets priorities and plans throughout the major areas. The emphasis of the plan places importance on correcting the issues that will occur once cheaper foreign imports replaced domestic products, and how to help domestic producers competitive under the new circumstances.[242] For the DR it would be important to maintain a clear focus that would allow it to foresee potential issues and concerns in order to adjust accordingly. Lack of a plan will continue to put the nation in a reactionary mode that is continuously attempting to catch up the dynamic and unforgiving circumstances.

As the DR marches down the roads towards more open trade, it will be extremely important that it invests considerable efforts towards the development of human capital. Increased attention on educational programs that will provide a smarter workforce is a necessary component that needs to be addressed if the nation is going to maintain sustainable growth. The DR government has initiated plans that will ensure that state schooling is provided for all children starting at the age of five. One educational program that was implemented required the hiring of 1900 teachers to provide schooling for an additional 40,000 children that until 2007 were outside of the educational system. The DR Education Secretary, Alejandrina German, stated that "we are well aware of our commitment to guarantee that by 2015, all 15 year old children will have at least nine

[241] Anonymous, "The Challenge of CAFTA," *Latin Finance*, September 2005.

[242] Cándida Acosta, "Consultor ve país requiere de estrategia desarrollo ante TLC," *Listín Diario,* August 31, 2007, http://www.listin.com.do/app/article.aspx?id=26672 (accessed June 3, 2009).

years of top quality education."[243] There is general acknowledgement that education is the key to the nation's ability to attain economic and social development, but the realty is that only small sectors of Dominican society have access to the form of schooling that opens the door to top-tier jobs. This lack of accessibility towards high quality and bilingual jobs could hold the nation back as it continues to become more involved in global trade.[244]

Even at lower educational levels it will be important to have a capable workforce that will be able to take advantages of different types and levels of production. Costa Rica provides a great example of the benefits achieved by having an educated workforce that can work in the high technology and semi-conductor industries. Costa Rica was able to attract an Intel computer chip assembly and testing plant that alone brought US$500 million in FDI to the country during the 1990s. This plant was the first Intel venture in Latin America, whose contract was won over Mexico due to the nation's overall competitiveness, wage rates, and qualified labor.[245] The plant was letter augmented in 2003 by a US$110 million injection that helped the nation expand its enterprises in chipsets for personal computers. Costa Rica has also taken the lead in the production of optical and medical equipment and other types of machinery, which has helped it to become the fastest growing and most diversified trader of CA.[246] Costa Rica's success in diversification is partly due to the fact that its educated workforce was able to provide the needed level of labor required and develop a distinct competitive advantage. The latter is a pattern that the DR can use as blueprint as its economy continues to diversify and expand.

The DR will also have to take serious steps to resolve the problems associated with the country's mediocre infrastructure and routine power outages. As expected trade starts to grow, it will be extremely important for the DR to have the adequate roads,

243 Jules Stewart, "Dominican Republic-Recovery Efforts Come to Fruition," *The Banker*, September 1, 2007.

244 Ibid.

245 Erika Morphy, "Dominican Republic: US trade-One by One," *Foreign Direct Investment*, December 2005.

246 J.F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The Dominican Republic-Central America-U.S. Free Trade Agreement (DR-CAFTA*), July 6, 2005, 14.

transportation systems, airports, and seaports to move commodity products around in an efficient and reliable manner. This is an aspect that needs to be dealt with consistently if the DR is going to reap the maximum benefits.[247] In 2007, President Fernández, acknowledged that although the DR had one of the most developed infrastructures in the Caribbean region, there were still many things that needed further work. In the last decade, the nation has worked significantly to improve and expand its airport network and established the $300 million Caucedo megaport facility, one of the largest seaports in the Caribbean located due east of Santo Domingo, the nation's capital. The nation has also worked on modernizing and expanding the port facilities in San Pedro de Macoris, Puerto Plata, and Montecristi that will be used to facilitate greater volumes of cargo as well as tourism.[248]

What has been encouraging is that although the DR is working hard to fix the infrastructure problems, the DR government is not alone in taking on the burden of fixing the issues. New laws enacted in the DR allow more public-private partnerships to help provide the needed changes. Through the Infrastructure Projects Law, foreign and domestic investors are invited to help and finance many projects, such as the building of roads and the installation of potable water pipelines, especially in the marginalized areas of the nation.[249] This is a good step for the DR, since it brings together many different sectors of the country, and allows them to take ownership and vested interest in the development of the country. Yet the largest problem by far that the nation is confronting revolves are around the issue of electricity supply. In the DR, electricity is a service that costs 21 cents per kilowatt, while electricity in CA runs on an average of 10 cents, and the provision of the service can be quite unreliable. Many regard this issue as one of the key impediments to new business and what makes the DR less attractive than its CA counterparts.[250]

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[247] Jules Stewart, "Dominican Republic-Recovery Ripples," *The Banker*, September 1, 2007.

[248] Jules Stewart, "Dominican Republic-Optimism For A Winning Formula, " *The Banker*, September 1, 2007.

[249] Ibid.

[250] Karen E. Thuermer, "Dominican Republic: DR-CAFTA-Joining the CAFTA Club," *Foreign Direct Investment*, December 2005.

The DR realizes this is a major problem and is trying to contain the problem on multiple fronts. The government is driving the effort by constructing two 600 megawatt power plants that will be in line by 2009, and developing different hydroelectric plants to provide the DR with an additional 290 megawatts of power.[251] In a further effort to diversify the entire generation system, which is currently petroleum based, the DR is using hydroelectric dams, imported coal, and natural gas. At the same time, the DR government is working hard to encourage the use of ethanol, wind, and solar energy to contain the enduring problem.[252] The private sector has also taken on important investments in trying to diversify its energy sources by using ethanol and constructing carbon burning plants.[253] These are positive steps in the right direction that will help the nation establish the needed environment to attract the highly desired FDI, especially from U.S. firms that will demand a high level of reliability in necessary inputs of production.

Another challenge that the DR will have to deal with will be making sure that the firms involved in manufacturing maintain their competitive edge by investing in modern equipment. China will maintain a relative advantage in certain areas, in part due to their better and newer production equipment. The DR can remain competitive due to its location and access to the U.S. market by keeping up with more efficient and updated methods of production.[254] Other areas that will help the DR's transition will be the following: assuring access to updated global services such as telecommunications, data networks, and insurance; facilitating lines of credit, especially for developing sectors; promoting and expanding commerce and investments, especially when they develop strategic partnerships; and developing policies that allow increased access to knowledge and innovation.[255]

All of the adjustments will not be easy for the DR, but what is evident is that there

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[251] Jules Stewart, "Dominican Republic-Optimism For A Winning Formula, " *The Banker*, September 1, 2007.

[252] Anonymous, "Dominican Republic- Membership with Privileges," *The Banker*, February 5, 2007.

[253] Jules Stewart, "Dominican Republic-Recovery Ripples," *The Banker*, September 1, 2007.

[254] Erika Morphy, "Dominican Republic: US trade-One by One," *Foreign Direct Investment*, December 2005.

[255] Luis E. Núñez Santana, "Beneficios y Desafíos Económicos del DR-CAFTA," *Listín Diario,* March 24, 2007, http://www.listin.com.do/app/article.aspx?id=7222 (accessed June 2, 2009).

is no turning back on this new venture. Fortunately for the DR, President Fernández has been able to get backing from the Congress and many national sectors in order to guide the nation down the correct path. What will be important is that future Dominican leaders continue to attack the challenges collectively to ensure that the nation is in a position to take full advantage of new opportunities. In the new and competitive trading space it will be more important than ever to keep up with the demand of free trade or those same prospects will easily shift to other nations, including the other DR-CAFTA nations.

F. CONCLUSION

The reasons that led the DR to join the DR-CAFTA have to be attributed to a convergence of multiple factors. During the 1980s the country faced an overwhelming economic crisis that forced the nation to take austere economic measures in order to receive help from the IMF. The economic restructuring, which began to liberalize trade and open the nation's market, was accompanied with an alternative development strategy that the U.S. presented through the CBI. The CBI specifically attempted to change the Caribbean Basin's economic growth model by giving the beneficiaries the opportunity to export nontraditional goods towards the U.S. market. These first two factors initiated the transformation of the Dominican economy away from its dependence on primary exports towards light manufacturing and tourism. As the global trend to shift labor intensive jobs to low wage regions started, the DR was willing and able to take advantage of the CBI and become a global platform in the apparel and light manufacturing industries. In the DR, the majority of the export processing industries were able to take advantage of the highly promoted FTZ parks that were built throughout the island-nation. The growth in the export sector quickly changed the country to the point where the DR became one of the global leaders in apparel exportation by the end of the 1980s. This first transformation was the initial catalyst, which would eventually vector the DR towards seeking entry into the DR-CAFTA.

During the 1990s the DR continued to grow as reforms were taken to connect the country's trade to larger trading entities within the region. The process of Western Hemisphere regionalization helped to foster an environment of trade liberalization and open markets, while it provided new opportunities for the DR. The DR experienced impressive growth throughout the entire decade, but it also started to feel the effects and demands of regional and global competition. The NAFTA was the first major test for the DR and the other CBI recipients, and the newly formed trading bloc forced the Caribbean nations to take defensive actions to prevent businesses from shifting their operations. At the same time, the FTAA initiative introduced the entire hemisphere to the hope of creating an economic zone that would allow the unrestrained flow of goods and services. The initiative was to be enacted in one entire effort, and it was perceived that smaller trading blocs within the space could form the foundations of the colossal endeavor. For the smaller hemispheric countries like the DR, it became important to hold on to their established markets and many nations decided to look for strategic partnerships with each other to counteract the global pressures that were effecting their export led growth. Organizations such as the CACM and CARICOM became crucial entities within the Caribbean Basin that tried to integrate the nations, which had similar endowments. By reducing competition with each other, the nations hoped to exploit economies of scale and develop strategies that would help development in a united fashion.

The DR was geographically and economically in a position to act as the connecting bridge for trade in the Caribbean Basin. By establishing FTAs with both the CACM and the CARICOM, the DR hoped to act as the bonding agent that would connect the smaller islands of the Caribbean to the Spanish speaking nations of CA. This subregionalization posturing by the DR was undertaken in the framework of the FTAA initiative, but also in a collective stance to counter the fierce economic rivalry that was emerging from China and the rest of Asia. The CBI continued to be the main vehicle that the DR used to send the majority of its exports to the U.S., and the importance of maintaining that market outlet open drove it to seek an FTA with its main trading partner. For the DR the reliance on the U.S. market was even greater than its CA counterparts, and the lack of permanence of the periodically reviewed CBI put the DR in a vulnerable position. In 2003 just before the DR began to negotiate the U.S.-DR FTA, 85% of its exports were absorbed by the

American market, while the DR imported 49% from the U.S.[256] Thus, there was a sense of urgency for the DR to attain a FTA with the U.S., especially since other nations like the CACM members had initiated similar moves under the framework of the FTAA initiative. If the DR had not attempted to do so, it would have easily lost a greater share of the U.S. market to the CA nations, which had similar economic endowments and would have attained increased preferential treatment for their products and services. But the larger threat that complicated matters was the termination of global textile and apparel quotas in 2005 and the continued encroachment of Asian products on the U.S. market. This situation forced the U.S., DR, and the CA nations to look towards establishing a permanent strategic partnership to prevent further losses and maintain growth.

For the DR, the convergence of its economic transformation, the FTAA initiative, and pressures from global competition all came together to guide the nation towards the road of establishing a FTA with its CA neighbors and most importantly with its main trading partner, the U.S. The DR came to the conclusion that the opportunities or potential gains outweighed the losses or changes the nation would have to undergo in the process. Throughout the negotiation and initial implementation phase, the leaders of the DR had to deal with some of the adjustment costs that need to be absorbed in order to enter into the agreement. What is important to emphasize is that in the new and challenging global climate, the DR's potential can only be obtained if the nation develops and implements a sound strategy on how all the national sectors can advance and adjust during this new transformational stage. The country's desire to maintain and attract increased sources of FDI and to sustain it export driven economy appears to be the number one goal the DR wished to achieve. The FDI was the key component to increasing business, and also acts as the fuel that also helped drive many of the other national sectors. The FDI will be extremely important for the nation, but the DR has a fair amount of challenges that have already surfaced and will continue to arise before the FTA is completely in place. What will prove to be beneficial in facing the challenges is

[256] J.F. Hornbeck, U.S. Foreign Affairs, Defense, and Trade Division, *The Dominican Republic-Central America-U.S. Free Trade Agreement (DR-CAFTA)*, July 6, 2005, 16.

that the DR government and private sector continue to establish partnerships that help to contain and reduce the problems that will crop up. So far this has proven to be a good formula that has helped to create a sense of ownership in combating the problems that could stall the development of the nation.

The DR-CAFTA went into force in the DR on the March 1, 2007, and so far the overall results have been mixed. The DR was able to post an impressive 8.47% growth in GDP for 2007, which was actually down from the record 10.67% growth experienced during 2006.[257] But the respectable growth did not hide the fact that certain key figures that were expected to see growth under the DR-CAFTA had actually decreased. The first negative indicator was that the nation continued to experience a decrease in total exports. The decrease in total exports was becoming a disturbing trend for the nation that had seen a 4% drop in total exports during 2006 and a 7% drop in 2007. The apparel and textile industries in the FTZs suffered significant contractions in 2006 with a 17% drop in exports due to the appreciation of the DOP, increased Asian competition, and a government mandated increase in salaries.[258] Economists in the DR were particularly shocked when it was revealed that the trading balance between the U.S. and the DR increased to a negative 150%, while the overall volume of trade remained the same. Many Dominican leaders were expecting that the DR-CAFTA would increase the nation's volume of trade, and that the DR would become a net exporter in terms of overall value. When the DR, compared itself to El Salvador, which had increased exports by 11%, Nicaragua and Honduras with increases of 5%, and Guatemala with a decrease of 2% during 2007, it realized that it was the nation with the worse overall performance.[259]

The disappointment of the first year results was of significant concern, and several analysts tied to find the reasons why the DR had done so poorly. Fernando Capellán,

[257] Inter-American Development Bank, "Latin America and Caribbean Macro Watch Country Table-Dominican Republic, 1997 to 2007," http://www.iadb.org/res/lmw_countrytables.cfm?country=Dominican%20Rep (accessed June 8, 2009).

[258] U.S. Department of State, Bureau of Western Hemisphere Affairs, *Dominican Republic*, December 2008, http://www.state.gov/r/pa/ei/bgn/35639.htm (accessed June 6, 2009).

[259] Cándida Acosta, "El país 'se quema' en la implementación del TLC," *Listín Diario,* October 15, 2008, http://www.listin.com.do/app/article.aspx?id=77222 (accessed June 6, 2009).

President of ADOZONA, pointed out that certain rules that were supposed to be removed by the DR-CAFTA in the textile and apparel industry have not allowed the DR's FTZs to a take full advantage of the agreement. Specifically, Capellán pointed out to several rules of textile accumulation, which clarify the composition percentage of each export to be considered a product from the region, and thus tariff free. Some of these rules that regulated the potential textile exports had not been resolved by the USTR and U.S. Congress in 2007, and according to Capellán they were hurting Dominican export firms. Capellán stated, "Basically the industry has not made great strides in DR-CAFTA, due to those problems that we face in Washington. The protectionism that currently exists has blocked some of our strong initiatives."[260]

In a different analysis, Robert Fannin, U.S. Ambassador to the DR, claimed that the DR's poor performance could be attributed to the fact that the laws, norms, and resolutions related to the DR-CAFTA's implementation have not been applied universally across many areas. According to Fannin, the agreement has brought about what it had promised, which was an increase in FDI and exports.[261] Unfortunately, the latter statement contradicts the results reported in several sources including the Inter-American Development Bank, which reported an investment growth decline from 21.33% to 12.49% between 2006 and 2007 and an overall trade balance hovering around -21% for the same period.[262] The negative indicators could have been part of the initial adjustment period, and since the other nations had enforced the FTA a year earlier, they had overcome the preliminary phase. Statistics for the 2008 are harder to interpret due to the global economic downturn, yet despite the downward trend the DR's GDP grew at 5.26%. [263]

Although there are several negative indicators that the DR will have to deal with,

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[260] Cándida Acosta, "Proteccionismo EEUU impide beneficio TLC," *Listín Diario,* March 28, 2008, http://www.listin.com.do/app/article.aspx?id=52973 (accessed June 6, 2009).

[261] Anonymous, "Lack of transparency hinders free trade's benefits, U.S. ambassador says, " *Dominican Times*, January 15, 2009, http://www.dominicantoday.com/dr/economy/2009/1/15/30769/Lack-of-transparencyhinders-free-trades-benefits-US-ambassador-says (accessed June 5, 2009).

[262] Inter-American Development Bank, "Latin America and Caribbean Macro Watch Country Table-Dominican Republic, 1997 to 2007," http://www.iadb.org/res/lmw_countrytables.cfm?country=Dominican%20Rep (accessed June 8, 2009).

[263] Ibid.

there are sources and optimists that point out that the DR's economy has started to shift or transform one more time. While the DR continues to lose textile and apparel jobs to Asia and CA, other export firms in the FTZs specializing in the tobacco, jewelry, medical, electronics, plastic goods, and pharmaceutical sectors have all reported increases during the last few years.[264] This new shift accompanied by growth has helped to offset the losses in the textile and apparel industries, and appears to be a natural outgrowth of trade liberalization and the open markets' ability to shift production towards areas were efficiencies can be exploited.

President Fernández and Finance Minister Bengoa both acknowledge that a transformation in the DR is underway, and they have taken positive steps to aid in the conversion process. One of the key ways the DR government is contributing to the change is by incorporating small and medium size enterprises (SMEs) and individual entrepreneurs into the new economic environment through a program called Promipyne. The plan not only incorporates SMEs into the bigger trade picture, but it also helps to stimulate labor by providing micro-financing, especially in economically marginalized areas.[265] What is clear is that the DR will need to come up with creative solutions, especially as the FTZ industrial model comes to a close for certain sectors of the economy. The promotion of the SMEs is an example of how the business concept must change in order to face global competition.[266] It is also important to see that the shift is toward the production of items that require higher levels of education and specialization. It is hoped that the decline of certain less efficient sectors will help pave the path for more sophisticated growth and expansion.

The new transformation will need support from many other sectors of Dominican society as the nation continues to diversify its economy. The overreliance on any one or small group of industries can prevent development, and the DR-CAFTA will provide the opportunities for the DR to continue to integrate itself further into the region and globe.

[264] Jules Stewart, "Dominican Republic-Recovery Ripples," *The Banker*, September 1, 2007.

[265] Jules Stewart, "Dominican Republic-Optimism For A Winning Formula," *The Banker*, September 1, 2007.

[266] Anonymous, "Free Trade Agreement DR-CAFTA Enters into Force After Years of Negotiations," *Inter Press Service*, March 1, 2007.

The success or failure of the DR-CAFTA will depend on the way that the DR manages the implementation and will have ramifications for a long time to come. The DR-CAFTA is not an agreement that the member nations can afford to try to undercut or work around. It will be important for the DR to taken the proper steps to help its implementation, or the nation will pay the price of potential isolation and marginalization. The hope is that the DR-CAFTA will help the DR achieve a greater level of stability and economic interdependence in the long run, which in turn will help it deal with its other increasing problems such as internal security, drug trafficking, increased violence levels, migration, and economic inequality. The DR has adjusted to changing circumstances in the past, and its leadership has the ability and willingness to continue to take the necessary steps to help the country advance in the ever competitive and shifting global environment.

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